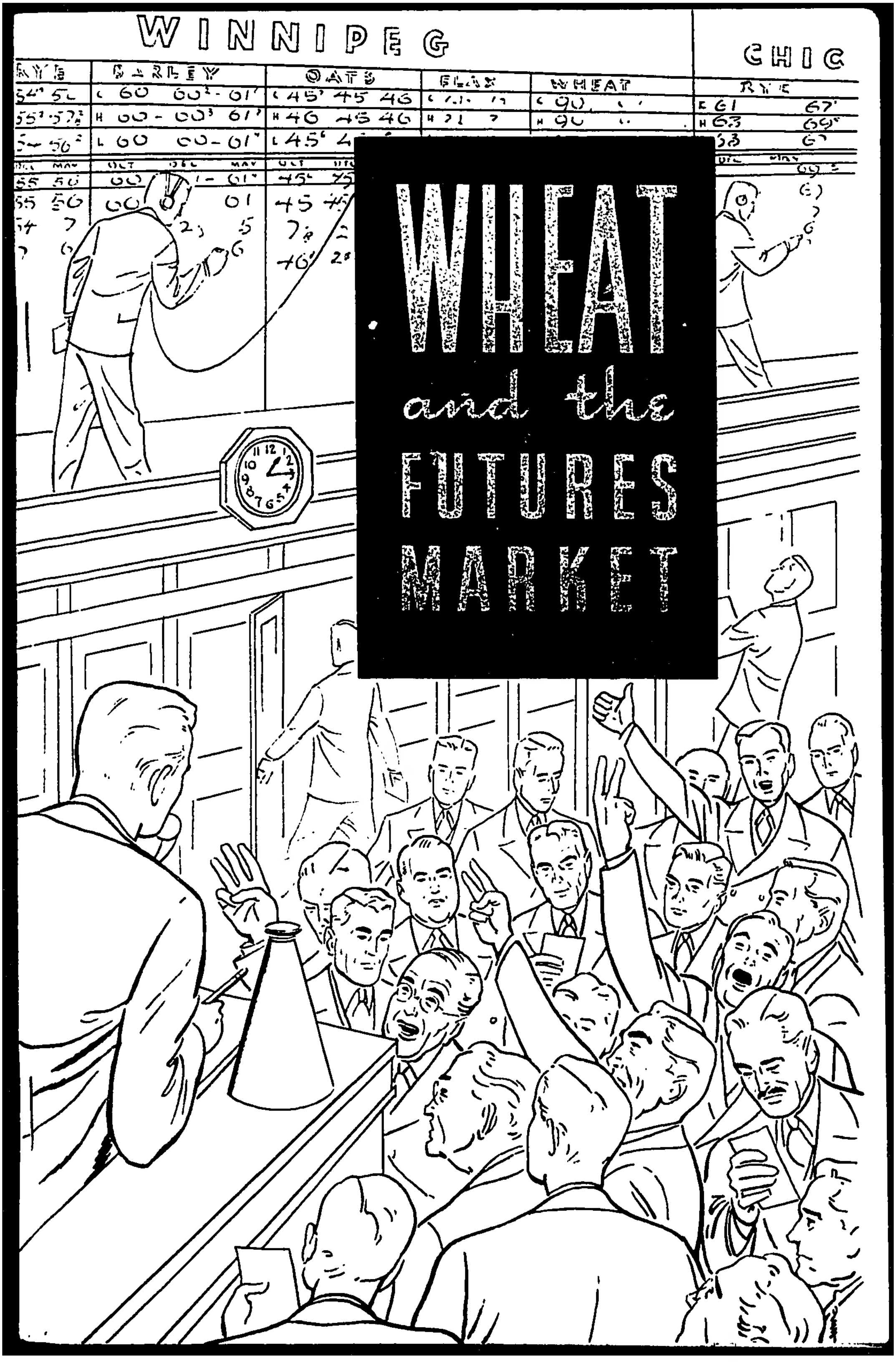
WHEAT and the FUTURES MARKET



WHEAT

and the

Futures Market

A Study of the

WINNIPEG GRAIN EXCHANGE

by

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The Grain Exchange Building

Foreword

During the past fifty years there have been fifteen Royal Commissions charged to make exhaustive investigations into the operations of the Grain Trade and of the facilities provided by the Winnipeg Grain Exchange.

By no stretch of the imagination can the reports of these Royal Commissions be classified as popular literature and, although their detailed contents and findings are of vital importance to producers, business men, and students, it is not surprising that very few people have found them attractive reading.

Despite the opportunity for study and food for thought which these Reports provide, there is no doubt that many people have, to put it mildly, an imperfect, not to say distorted, understanding of an economic system which through the years has become highly specialized, and is too complex to permit of a clear explanation in brief form.

There need be no apology, therefore, for this attempt to put into language as plain as possible this study of the Exchange, its functions, facilities, privileges, and benefits, with special reference to the operation of the Futures Market.

Although written during the war, it is based on conditions prevailing in normal peace times.

It has been penned in the hope that it will provide as clear and concise a picture as it is possible to have, without actual experience, of the place of the Futures Market in the Canadian Economy.

In it an attempt has been made to find an answer to the following questions:—

1. Does the Futures Market ensure the farmer a higher price for his grain than he would receive if there were no Futures Market?
2. Does it lower the operating costs of elevator organizations, exporters, millers, and other merchandizers of grain, thereby narrowing the difference between the price at which the farmer sells his wheat, and the price which the consumer in any part of the world pays for his flour?
3. Do any advantages which the Futures Market brings to elevator companies and other organizations connected with the entire wheat industry directly benefit the farmer?

4. Does it assist in financing each year's crops and in providing immediate cash payments to farmers for the grain they deliver?

5. Does it enhance the value of grain as security with the banks and others, and does it thereby induce a lower rate of interest on grain loans?

6. Does it facilitate export sales of wheat and flour?

7. Does it assist in retaining existing markets and in securing new ones?

8. Does it establish a true index of the value of Canadian wheat in the World's Wheat Market in comparison with the values of other wheats?

9. Is the Grain Exchange responsible for fluctuations in grain prices as these occur from time to time and from year to year?

10. Does it assist in providing and utilizing storage space in all parts of the Dominion?

11. What groups of people of their own free choice are members of the Grain Exchange and do use the facilities of the Futures Market?

12. Are elevator companies, exporters, millers and others obliged to become members of the Grain Exchange and must they use the Futures Market?

13. Is it obligatory for farmers' elevator organizations, wheat pools, and co-operatives to sell their grain through the medium of the Grain Exchange or to use the Futures Market?

14. Are there any methods other than the Futures Market that can be used to sell grain to domestic and world buyers?

Every effort has been made to adhere to facts, leaving intelligence and reason to do the rest.

"But facts are chiels that winna' ding,
And downa' be disputed."

—ROBERT BURNS.

Chapter One

THE WINNIPEG GRAIN EXCHANGE

The Winnipeg Grain Exchange is a voluntary association. It has no charter, no articles of incorporation. It is not exclusive. Membership can be obtained by anyone in any country in the world, whose credentials, financial and ethical, are satisfactory to the members.

Its objects as defined in the Constitution (1908) are briefly:

(a) To compile, record, and publish statistics, and acquire and distribute information respecting the grain trade; to promote the establishment and maintenance of uniformity in the business, customs and regulations among the persons engaged in the grain trade, to inaugurate just and equitable principles in trade and generally to secure to its members the benefit of legitimate co-operation in the furtherance of their business and pursuits.

(b) To organize, establish, and maintain an Association not for pecuniary profit or gain, but for the purpose of promoting objects and measures for the advancement of trade and commerce respecting the grain trade for the general benefit of the Dominion of Canada.

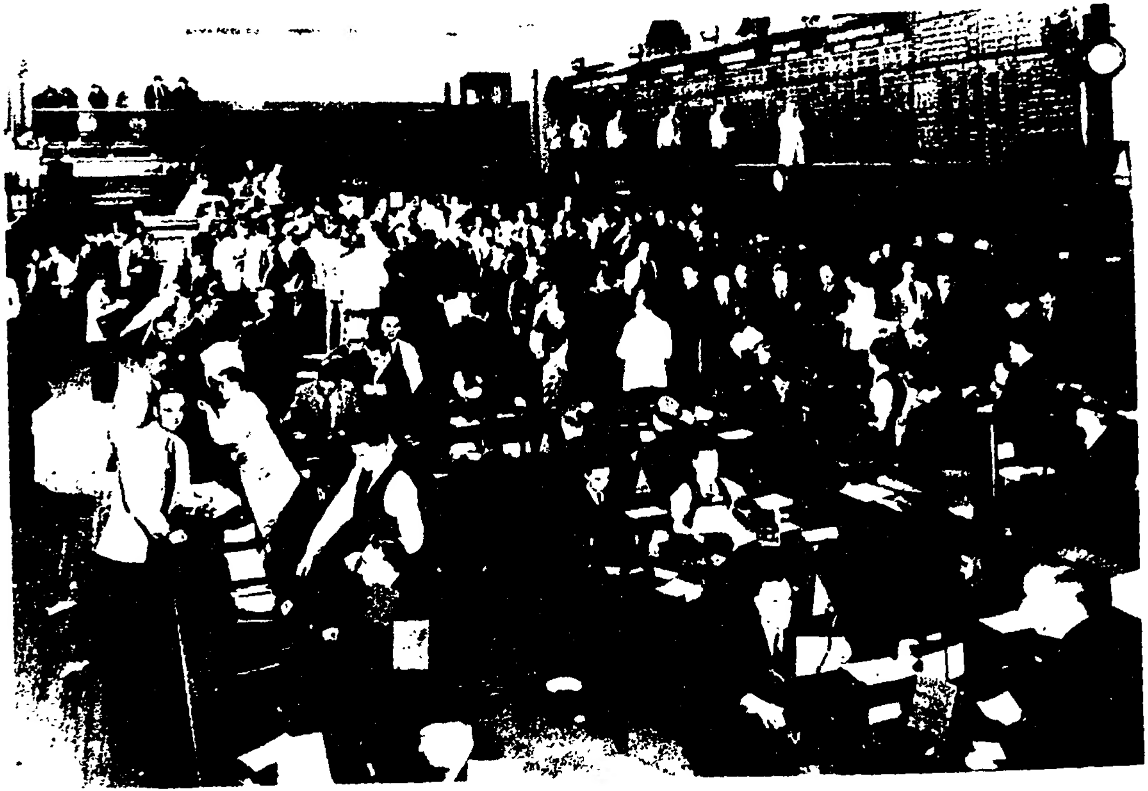
In pursuance of these objects it has provided a Trading Floor in what is known as the Grain Exchange Building although it is merely a tenant thereof and pays rent to the landlords as do all other tenants in the building.

It goes to considerable trouble and expense to assemble and distribute statistics, market quotations, crop and weather reports and other information from and to all over the world.

This world wide dissemination of information, including the continuous daily publication of prices and price changes, keeps buyers fully informed of the relative value of Canadian Grain. It is one of the most effective selling aids that so far has been devised.

It neither buys nor sells grain or Grain Futures. It has often been blamed for causing fluctuations in grain prices but in actual fact it has never been a party to a grain transaction of any kind in its long history. It has only provided facilities for others to trade.

Its operating expenses are met in the main by assessments on the members, fixed semi-annually and based on current expenditure.



Trading Floor — 50th Anniversary, Dec. 7, 1937

It has set up, developed and perfected its Futures Market, now one of the three great Futures Markets in the world.

It has laid down the conditions under which trading in grain, including the Futures Market, shall be conducted on the Exchange, and has adopted rules and regulations which govern all transactions not only between members but between members and non-members.

The sanctity of these rules, regulations and conditions of trading is zealously guarded, and any violation thereof is dealt with by censure, fine, suspension or expulsion.

It has no political affiliations; its membership includes adherents to opposing political parties, with differences of opinion which at times become somewhat pronounced.

Its membership includes shippers and exporters, millers and other processors, grain and feed merchants, owners of country elevators, owners of Pacific, Western and Eastern terminal elevators, owners of mill elevators, farmers' organizations, wheat pools, brokers, banks, railway companies, vessel owners, commission merchants, brokers, and foreign grain concerns located in almost every corner of the globe.

Not all of these are dealers or traders in grain. Canadian chartered banks are members because of their contact with other members of the Exchange in the matter of financing the crops.

Vessel owners are members because the floor of the Exchange is the market place for freight on the Great Lakes.

Railway companies are members because of the requirements of other members in the transportation of grain especially in Eastern Canada where the service is more competitive than in the West.

Neither banks, vessel owners, nor railway companies use the Futures Market in actual trading. Banks do use it as an index to the day by day value of the grain securities deposited with them as collateral.

There is no obligation on the part of any grain dealer, elevator owner, exporter, miller, or other merchandiser to be a member of the Grain Exchange, nor are they, whether members or not, obliged to use the Futures Market.

Nor is it obligatory for farmers' elevator organizations, wheat pools, or farmers' co-operatives to sell their grain through the

medium of the Futures Market or other facilities provided by the Exchange.

Any individual or organization is perfectly free in this democratic country to use any medium, method or system that he or they choose in their efforts to sell grain.

In peace times, during the past few decades, attempts have been made to sell grain through channels other than the Exchange, but these have proven abortive, not through any action by the Exchange or its members, but through the survival of a system best suited to the economic needs of the business of selling grain.

If any method, or medium, more efficient, sounder, or more economical is found, there cannot possibly be, nor has there ever been, any objection to anyone being entirely free to use it.

No one would be quicker to respond to any such move than would the experienced members of the Exchange itself, who in this most competitive of businesses are always looking for ways and means to reduce the difference between the price paid to the farmer and the price paid by the ultimate consumer.

It has become the focal centre of the leading industry in the Dominion, which is definitely internationally minded.

The importance of such a focal centre where buyers and sellers may meet has proven fundamental through the ages in many and various forms of merchandizing.

In London there is Covent Garden for vegetables, flowers and fruits, Smithfield for cattle, Billingsgate for fish.

The Cotton Exchange in Manchester, the Bazaar in Glasgow and the famous Falkirk Tryst are other examples of the same kind.

The Bourse in Paris, the Rialto in Venice, the Board of Trade in Chicago, and the Produce Exchange in New York, the Chamber of Commerce in Minneapolis, the Baltic in London, the Atlantic in Liverpool, the Board of Trade in Montreal, the Merchants Exchange in Vancouver, the Cotton Exchange in Manchester have all arisen from the same natural causes.

The Union Stock Yards near Winnipeg is another case in point, and the market space for garden produce provided in Winnipeg by the City Council and others is a simple form of the same community impulse.

Conditions of trade may vary but the basic need is the same. It is economic waste for scattered buyers and sellers to be seeking

each other in haphazard fashion. It is sound economy to meet at an established focal centre.

This continual daily association of buyers and sellers at an established market centre has resulted, over a considerable number of years, in the gradual development of a highly technical process of merchandizing the grain crops of Western Canada.

To those actively engaged in it, there is nothing complicated in this process. To them it is as simple as is the science of aeronautics to the aviation expert.

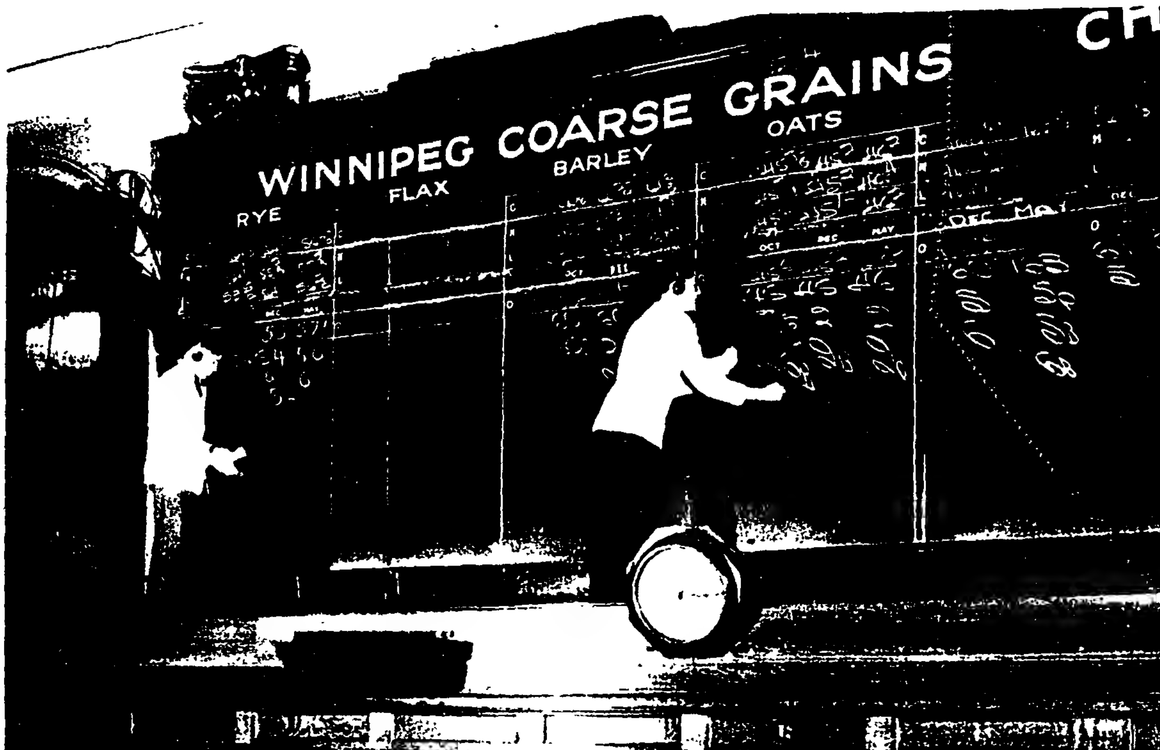
It has evolved a language of its own which to a grain man is eloquent in its expressiveness.

But to the uninitiated it appears to have gathered some aura of mystery which no amount of explanation seems able to dispel.

Its efficiency, the speed with which any quantity of grain of any quality, from a wagon load or car lot to several millions of bushels, can be sold, seems to suggest some kind of mental sleight-of-hand, to employ a mixed metaphor.

No element in this process contributes to this efficiency, and at the same time to this aura of mystery, as does the Futures Market.

It is in the hope that the fundamental meaning as well as the practical operation of the Futures Market may be better, if not wholly grasped, that these lines are written.



Trading Floor — Coarse Grain Quotation Board

Chapter Two

THE FUTURES MARKET

The Futures Market system was designed for the purpose of reducing to a minimum the risk of adverse price changes.

It is a system which has stood the test of years and which is relied upon, directly or indirectly, by practically every grain dealer in the world, and of which, consciously or otherwise, every farmer and every consumer gets the advantage.

The basic purpose of the Futures Market is to provide hedging facilities. What is meant by "hedging"?

A definition of "hedging" may be given as follows:

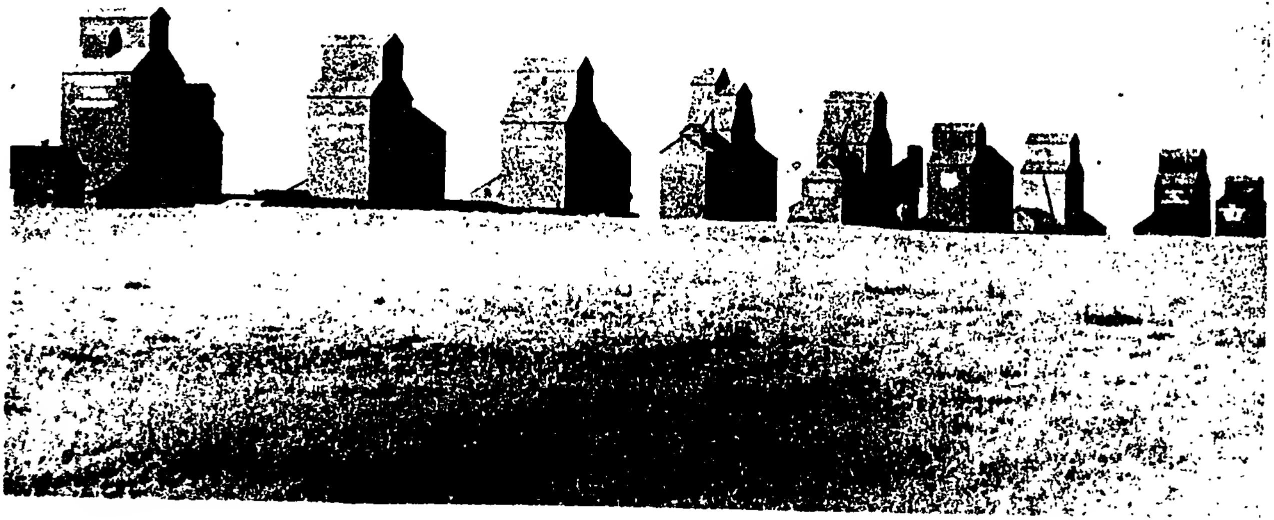
A "hedge" consists of a sale of Grain Futures on the Futures Market against an equivalent amount of grain purchased elsewhere, or a purchase of Grain Futures in the Futures Market against an equivalent amount of grain sold elsewhere.

The hedger who sells Grain Futures does so to guard against a decline in the price of grain he has purchased.

The hedger who buys Grain Futures does so to guard against a rise in the price of grain for which he has made a contract of sale.

It is the meeting of these two hedging operations that makes the Futures Market. There are side issues which from time to time intervene to cause variations in these operations, but the relation of actual grain to all trading in the Futures Market is fundamental. Without the contemplation of delivery of actual grain being made or taken no Futures Market could continue to function.

These are broad general statements and it is now essential to examine in some detail how the Futures Market of the Winnipeg Grain Exchange meets the test, and to scrutinize the use to which the Futures Market is put by the various elements concerned.



"Line" Elevators in Alberta

Chapter Three

COUNTRY ELEVATORS and the FUTURES MARKET

For the purposes of this review, the Futures Market for wheat alone will be referred to. There are similar Futures Markets provided for oats, barley, flax and rye, and these are all governed by the same rules, regulations and practices as that provided for wheat.

On every business day in every year, farmers in Western Canada are selling wheat to country elevators, whether these elevators are owned by the pools or the general trade.

In the aggregate these sales may represent some tens of thousands, some hundreds of thousands, or some millions of bushels.

The price which the farmer receives, whether it be for the wagon load or the car lot, is definitely governed by the price at which Wheat Futures are trading in the Futures Market.

Daily Purchasing

Now let us consider the position of an elevator company, buying daily from farmers anything from five thousand bushels at the tail end of a crop year to half a million bushels at the height of the season. These daily purchases may include One, Two or Three Northern, or any other of the Spring wheat grades.

There may be Durums, Garnets or Winters. There may be tough or rejected grades.

There is no certainty when any of these grades will be shipped out by the elevator company nor how long they will take to reach a mill or terminal elevator.

Buyers Prefer Wheat in Terminals

Exporters and millers in Eastern Canada have no reason to buy such wheat at country points when, generally speaking, supplies of the grades they want are available in cargo quantities in terminal elevators at the Head of the Lakes or at Vancouver.

Nor can they be induced to accept the elevator agent's or the farmer's idea of grade or weight when they can get supplies in terminals already graded by Government Inspectors and weighed by Government Weighmasters.

To this there are two minor exceptions, namely, in the case of (a) carlot shipments direct from country points to mills in the Prairie Provinces which can be inspected and weighed by

Government officials at Western Inspection points, and (b) carlot shipments, in which the agent's grade or weight is accepted by the buyer by special agreement, because it may be impractical to have the wheat inspected or weighed by Government officials.

The sale price in these instances, however, is based on the current price of the Wheat Futures in the Futures Market.

Delays Are Dangerous

If there were no Futures Market, the elevator company would, except by special arrangement, have to wait until the wheat purchased by the elevator agent had been shipped out by him, graded by a Government Inspector, and weighed into a terminal elevator by a Government Weighmaster, before they could make a sale to an exporter, or miller.

But if the elevator company had to wait that length of time they would run the risk of prices falling before they could sell.

True, prices might rise. But this is too problematical. As they have to keep on buying every day what the farmer wants to sell, they would act cautiously and make sure, if there were no Futures Market, that the price their elevator agent paid was well below that which exporters were then paying for wheat actually in terminals.

Competition with other elevator companies there would be, but all their competitors would be faced with the same risk, and would naturally exercise caution in the same way.

Futures Market Removes Dangers

The Futures Market, however, saves the situation, and enables the elevator company to pay prices close to those then being paid by exporters for wheat already in terminals.

The Grain Exchange has provided that Futures contracts may be made between sellers and buyers for the delivery of wheat at Fort William or Port Arthur during certain designated months, usually October, December, May and July. These are called in trade language "Contract Months."

October Futures are associated with the first movement to market of a new crop, December Futures with the situation existing after the close of navigation on the Great Lakes, May Futures with the re-opening of navigation on the Great Lakes, and July Futures with the final movement to market of the previous year's crop.

The elevator company having sold Wheat Futures have the option of delivering any one of seven grades of wheat at certain specified differences, for example One Northern at the contract of sale price, Two Northern at three cents less than the contract of sale price, Three Northern at eight cents less and so on.*

They have also the option of making delivery on any day during the contract month within specified business hours.

The exporter having bought Wheat Futures on the other hand has to await the seller's pleasure as to grade and time of delivery.

Simple Example

What does this all mean? Take a simple example.

Let us suppose that an elevator company purchases at several of their country elevators on one day in September a total of say 10,000 bushels of One Northern wheat, the grade of which has been agreed upon between several farmers and several of the company's agents. Their purchases may exceed this, and be of different grades, but for demonstration let us follow this 10,000 bushels of One Northern through to its final sale.

Let us suppose that on that day in the Wheat Futures Market the October Wheat Future closes at 92c.

On this assumption, relying on the Futures Market, the elevator company would pay the farmers, for this One Northern, 92c per bushel, less commission, freight, and other legitimate charges.

Advices of the purchase of this 10,000 bushels of One Northern by the country elevator agents are wired by them to the head office in Winnipeg.

The elevator company is accordingly the owner of 10,000 bushels of One Northern for which there is no direct sale, the wheat being at these country points, while the exporters want only One Northern wheat at the Head of the Lakes.

At the opening of the Futures Market the following morning the elevator company sells 10,000 bushels of October Wheat Futures at a price as near as possible to the previous day's close of 92c. They may have to take a lower price or they may get a higher price or they may get the same price.

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* *See page 72.*

But whatever price they get it is almost invariably within a fraction of a cent of the previous day's close.

This sale of October Wheat Futures is then registered with the Clearing House.*

The position of the elevator company now is that they own (or are 'long' as the trade says) 10,000 bushels of One Northern Wheat scattered over several points in the West and they have sold (or are 'short' in trade language) 10,000 bushels of October Wheat Futures.

In other words the elevator company have "hedged" their agent's purchases of wheat at country points by selling an equal amount of October Wheat Futures in the Futures Market.

Definite Obligation to Deliver Wheat

In selling this 10,000 bushels of October Wheat Futures they have made a definite contract to deliver 10,000 bushels of actual wheat through the Clearing House on any day of their own choosing during the month of October. This contract, in which delivery of actual wheat is contemplated, is known as a "Wheat Future."

Note that the contract is for wheat, not necessarily One Northern. As already explained, sellers of Wheat Futures have the option of delivering any one of seven grades of wheat in fulfilment of a contract. † These are called in the trade "deliverable" or "Contract" grades.

Procedure of Delivery

But let us assume again that the elevator company decides to deliver this 10,000 bushels of One Northern Wheat and in due course they ship it to the Head of the Lakes.

After it is inspected by Government Inspectors, and unloaded and weighed by Government Weighmasters at a terminal elevator at Fort William or Port Arthur, they receive warehouse receipts covering it, and deliver these warehouse receipts through the Clearing House in fulfilment of their contract and receive payment.

The price in that payment is not that at which the elevator company originally sold the October Wheat Futures. The price paid is that of the October Wheat Futures on the day on which delivery is made.

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* *See page 58.*

† *See page 72.*

It is more than likely that on the day they make delivery through the Clearing House the price of October Wheat Futures in the Futures Market will not be the same as it was on the day in September when they sold the 10,000 bushels of October Wheat Futures.

How then is the difference adjusted?

Let us assume that the price at which they sold the October Wheat Future was 92c, and that on the day they make delivery the October Wheat Future is trading at 93½c.

As the price of the October Wheat Future had advanced from 92c to 93½c the elevator company therefore had been obliged to deposit with the Clearing House 1½c per bushel on the 10,000 bushels of October Wheat Futures they had sold. This is deposited in accordance with the rules of the Clearing House as a guarantee of fulfilment of their contract. *

Therefore when they delivered the 10,000 bushels of One Northern through the Clearing House in fulfilment of their contract they would receive 93½c, i.e., 92c plus a refund of the 1½c which they had been called on to pay into the Clearing House by reason of the advance in the market.

Summary

In dollars and cents per bushel the final result may be stated as follows:

Paid to farmer (less commission, freight and other charges)	92c
Deposited with Clearing House	1½c
	93½c
Payment received through the Clearing House	93½c

Procedure When Market Declines

If, however, the October Wheat Futures decline to say 90½c the whole process is reversed. The elevator company is entitled to and does withdraw from the Clearing House the amount of the decline from 92 to 90½c (1½c), which amount had been de-

* *See page 59.*

posited with the Clearing House by the purchaser as a guarantee on his part of fulfilment of his contract.* When they deliver the 10,000 bushels of One Northern through the Clearing House, they would receive payment at 90½c, which with the 1½c already withdrawn from the Clearing House, would give them their original sale price of 92c.

In dollars and cents per bushel the final result in this case may be stated as follows:

Paid to farmer (less commission, freight and other charges) . . .		92c
Withdrawn from Clearing House	1½c	
Payment received through Clearing House . .	90½c	92c

Many Grades Other Than One Northern

In actual practice the elevator company is buying not only One Northern Wheat but many grades from many farmers at many points and not on one day alone but on every business day. They do not stop buying so long as the farmer wants to sell.

But they are able to keep up this buying only because they know that at any time they can sell for delivery in October (or any other of the designated months) through the medium of the Futures Market just as much Wheat Futures as they buy wheat from farmers from day to day.

Sound Policy of Balanced Purchases and Sales

It is easy to see therefore, that in their scattered country elevators an elevator company continuously owns many bushels of many different grades of wheat, bought by their agents from farmers at many different prices.

At the same time they have entered into many contracts of sale of Wheat Futures, also at many different prices, but which in the total equal the number of bushels of farmers' wheat they now own.

It is sound business practice to keep the volume of their purchases of wheat from farmers at country points and their sales of Wheat Futures as nearly equal as they can, so that no matter whether the prices in the Futures Market go up or down the elevator company's position is not affected.

The business of an elevator company is to warehouse and merchandise grain, that is to say, to store it, and also to buy and

* *See page 59.*

sell it as nearly at the same time as they can. The Futures Market enables them to do this.

Any departure from this primary principle is fraught with risk, and it should not be necessary to cite instances in which that risk has been real, and its assumption has had results which, to put it mildly, have been unfortunate.

All Elevator Companies Adopt Same Safeguard

It is, of course, understood that it is not only one elevator company that is continuously buying wheat from farmers at country points and selling Wheat Futures in the Futures Market, but that all elevator companies, pools included, are doing exactly the same thing.

First Variation in Delivery

As already pointed out the seller of wheat futures in the Futures Market has the option of delivering through the Clearing House any one of seven grades,* and he can make such delivery on any day he chooses during the contract month.

For the purpose of explanation we will take October as the contract month. The other contract months, December, May and July, function just the same as October.

Premiums

Unless the purchaser, therefore, is willing to await the seller's pleasure as to grade and date of delivery in the contract month, he has to offer some inducement to the seller if—

1. He desires delivery of a grade other than the grade which the seller plans to deliver.
2. He desires delivery earlier or later than on the date on which the seller proposes to make delivery.
3. He desires delivery of a specific grade on or between specific dates.

That inducement in trade language is called a "premium" and is in the form of an increase in the price which the seller otherwise would receive through the Clearing House.

Competition in Premiums

If several purchasers of October Wheat Futures desire similar concessions as to grade and date of delivery, there is competition, and the amount of the premium depends on the keenness of the competition.

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* *See page 72.*

Example

It will doubtless be easier to understand how this "premium" is obtained if we take a concrete example.

Let us take Three Northern wheat which has consistently commanded a "premium" over its delivery basis during the past two or three years.

Three Northern is one of the seven contract grades and if the seller were to deliver this grade through the Clearing House, at his own pleasure, during October, he would receive 8c less than his contract of sale price.* In other words if he had sold the October Wheat Future at 92c he would receive 84c for Three Northern.

Premium on Three Northern

Let us assume, however, that a purchaser of October Wheat Futures desires delivery of Three Northern at a terminal in the first ten days of October and is willing to pay a premium of 3c per bushel for this delivery on condition that delivery of this grade is made direct to him and not through the Clearing House.

The elevator companies immediately advance their price to the farmer. If they can purchase some Three Northern from farmers, make delivery of this grade at a terminal in the first ten days of October and are satisfied with the 3c per bushel premium, they will sell the Three Northern and on making delivery will be paid 5c under their Futures contract of sale price instead of the scheduled 8c.

In other words instead of receiving 84c on their sale of October Wheat @ 92c, they will get 87c, and instead of paying the farmer 84c (92c less 8c) they will be paying him 87c (92c less 5c), less commission, freight and other charges.

Procedure

The procedure in this case then is as follows:

Let us assume that the October Wheat Future is 93½c on the day on which the elevator company delivers direct to the purchaser the Three Northern Wheat for which a premium of 3c per bushel had been agreed upon.

The elevator company is under their previous obligation to deliver wheat in October through the Clearing House @ 92c (i.e., One Northern).*

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* *See page 72.*

As October Wheat has advanced to 93½c, the elevator company has been called on to pay and has paid to the Clearing House 1½c as a guarantee that they will fulfil their contract.*

But under this new arrangement the purchaser requires that the elevator company shall deliver Three Northern direct to him and not through the Clearing House.

How, then, does the elevator company recover the 1½c which they have deposited with the Clearing House?

Firstly, the purchaser of the Three Northern sells the elevator company the equivalent amount of October Wheat Futures @ 93½c, which they then register with the Clearing House, thereby balancing their account with the Clearing House. *

Next, the purchaser pays them for the Three Northern 5c (i.e. 3c premium) under 93½c (i.e. 88½c) which is 1½c more than they would have got if they were paid 5c under 92c, the original contract of sale price of the October Wheat Future.

Instead, therefore of recovering in this instance the 1½c deposit through the Clearing House they recover it in the price which the purchaser pays them for the Three Northern.

In dollars and cents per bushel the final result may be stated as follows:

Elevator Company's Account with Clearing House

Sold October Wheat Future and registered with Clearing House........@	92c
Deposited with Clearing House as guarantee of good faith...............	1½c
	93½c
Purchased October Wheat Future from exporter and registered with Clearing House	93½c

Elevator Company's Account in Three Northern

Paid to farmer (less commission, freight and other charges) 92c less 5c	87c
Deposited with Clearing House on advance of market........................	1½c
	88½c
Payment received from exporter direct (93½c less 5c)	88½

* See page 59.

Premiums on Other Grades

This kind of premium might at times be obtainable for any or, in fact, all the scheduled seven deliverable grades. *

The premium might vary for each grade depending on the competition among purchasers. It might be only ⅛c, but it has been as high as 20c for One Northern.

Benefit to Farmers

Now it may be asked if these premiums, when they exist, show up in the prices being paid to the farmers by the elevator companies at country points.

The answer to that question is that these premiums are reflected definitely in the prices being paid to the farmers at country points.

Benefit if in Terminal

If a farmer after delivering his wheat to the country elevator, decides not to sell it until it is shipped out in a car lot and is unloaded at a terminal, he will be paid the exact premium that is being paid by the purchaser at the time the farmer sells.

Benefit if in Country

In the case of farmers' wheat, in wagon load or car lot quantities, which is not shipped out of the country elevator or is not unloaded at a terminal elevator, the situation is different.

Premiums arise out of some scarcity of supply and the urgency of a purchaser.

The elevator companies know that the premium which a purchaser is paying for wheat actually in the terminal elevator at the Head of the Lakes is not necessarily obtainable for wheat at country points; but it frequently happens that the purchaser will offer to pay premiums for specified grades of wheat for delivery at the Head of the Lakes three, four, or more weeks ahead, as in the case of the Three Northern cited. †

If, therefore, the elevator company is sure of being able to get these grades of wheat shipped out of the country elevator and unloaded at the terminal elevator in time to make delivery within the time desired by the purchaser, they are quick to take advantage of the chance to make sales at such premium prices.

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* *See page 72.*

† *See pages 18-19.*

They are, therefore, able and willing to pay these premiums to the farmer. In fact, they have to pay them to the farmer, because if they offer less their competitors will be only too glad to pay them.

Use of Futures Market Still Essential

This effort on the part of the elevator companies to secure premiums on wheat delivered some time ahead does not interrupt their use of the Futures Market.

As previously stated their first action after buying from farmers any grade of wheat at a price which includes the premium, or not, is to sell an equivalent amount of Wheat Futures in the Futures Market in order to keep their purchases and sales balanced.

Then, in order to make sure of getting back the premium which they have paid to the farmer, they contract to deliver by an agreed date the specified grade they have bought at the specified premium, the delivery procedure being the same as in the case of the Three Northern already cited.*

Legal Delivery

Up to this point attention has been focussed on the seven contract grades of wheat which the seller of Wheat Futures on the Futures Market has legally the option of delivering through the Clearing House on his contract sale. †

There are, however, many other grades of wheat which are sold by the farmer to the country elevator, and which find their way to the terminal elevators at Fort William and Port Arthur, but which the elevator company cannot deliver through the Clearing House on their contract of sale of October Wheat Futures.

Non-Contract or "OFF" Grades

These non-deliverable grades or "off" grades, as they are labelled in the trade, such as No. 5, No. 6, Feed, Toughs or Rejecteds, etc., can also be delivered by the elevator company to a purchaser under an arrangement by which the elevator company will still be able to fulfil their obligations on their contract of sale of Wheat Futures made in the Futures Market.

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* *See pages 18-19.*
† *See page 72.*

Any of these "off" grades may be delivered to a purchaser of such Wheat Futures by mutual agreement between the seller and the purchaser, but delivery must be made direct to the purchaser and not through the Clearing House.

Procedure

Exactly the same procedure is followed as in the instance of the Three Northern previously mentioned.*

Let us take for example Number Six Wheat, and let us assume that this grade is worth, in competition on the open market, 18c under the October Wheat Future.

You will remember that in the cited example of the Three Northern the value in competition on the open market was 5c under October, as members of the trade would express it.* This is called trading "basis the Future" or trading "basis exchange of Futures."

Now again let us assume that when the elevator company bought this Number Six wheat at the country elevator, the price at which they sold an equal amount of October Wheat Futures was 92c.

They would then have paid the farmer 74c (18c under 92c) less commission, freight and other charges.

Delivery of an "OFF" Grade

The elevator company having had this Number Six wheat shipped out and unloaded in a terminal elevator now sells it to an exporter or miller at 18c under October.

Let us assume that the October Wheat Future has declined to 90½c. This, of course, is 1½c less than the price at which the elevator company had sold the October Wheat Future (92c) but as the elevator company was entitled to withdraw and had already withdrawn 1½c (the amount of the decline) from the Clearing House, the obligation of the Clearing House to see that the elevator company was paid 92c was reduced to 90½c.†

On this sale of Number Six wheat sold "basis exchange of Futures" at 18c under October, the purchaser would sell to the elevator company the equivalent amount of October Futures at 90½c and would buy from the company in exchange the same

* *See pages 18-19.*

† *See page 59.*

amount of Number Six wheat at 18c under this price which would be 72½c.

In dollars and cents the final result may be stated as follows:

Elevator Company's Account with Clearing House

Sold October Wheat Future and registered with the Clearing House.. .		@ 92c
Purchased October Wheat Future from the exporter and registered with the Clearing House	@ 90½c	
Withdrawn from the Clearing House on decline of market	1½c	92c

Elevator Company's Account in Number Six Wheat

Paid to Farmer 92c less 18c (less commission, freight and other charges)		74c
Payment received from exporter direct 90½c less 18c	..72½c	
Withdrawn from Clearing House on declining market	1½c	74c

Net Result the Same

So you see that no matter whether the October Wheat Future advances or declines the net result is the same when the Futures Market is used in this way, namely, as a "hedge" against purchases from the farmer.

Competition Among Elevator Companies

All the elevator companies, pools included, have the same confidence in the Futures Market, and the competition among them in buying "off" grades from the farmer is just as keen as it is with the deliverable or contract grades.

This competition ensures that the farmer receives the full market value for all grades of wheat on the day he wants to sell.

Only Seven Grades Legally Deliverable

While the custom of the trade is that all grades, contract or non-contract, are delivered either direct to the purchaser or indirectly to the purchaser through the Clearing House, there is always the outside chance that a purchaser may not agree to accept any grade except one or all of the seven contract grades.*

Every elevator company knows this and exercises the greatest care to make sure that, in case a purchaser might insist on his strict rights, they will have sufficient contract grades available to fulfil their contracts of sale.

They dare not let themselves get into the position of not being able to deliver contract grades on their contracts of sale for, say

* *See page 72.*

October, if a purchaser cannot be induced to accept "off" or non contract grades which they might be able to deliver.

Serious Responsibility in Futures Contracts

The Council of the Exchange takes a serious view of any defaults on contracts of sale of grain Futures and imposes severe penalties for non-fulfilment of such contracts.

This point must be made quite clear. A Purchase or Sale of any grain Future on the Futures Market is no "scrap of paper." Delivery of actual grain is always contemplated and woe betide either the purchaser or seller who fails to meet the obligation he undertakes in being a party to a contract made in the Futures Market.

Possible Way Out

There is usually a way out for an elevator company (or any one else for that matter) who, realizing their responsibility in their sales of, say October Wheat Futures, and, who, looking far enough ahead, see that they may not be able (or may not want) to deliver contract grades on such sales.

What they do is described in the language of the trade as "switching their hedges."

They purchase sufficient October Wheat Futures in the Futures Market, which they then register with the Clearing House, thereby balancing out their sales of October Wheat Futures previously registered, and they sell an equal amount of December, or May, or July Wheat Futures. By this means their obligations in the Clearing House have been deferred until a later date.

By this means also, their sales of Wheat Futures and their stocks of actual wheat purchased from the farmers remain balanced.

Whole Picture

But the whole picture shows that by using the Futures Market to make sales of Wheat Futures continuously as they make purchases daily from the farmers, the elevator companies are able to take practical measures to eliminate, or at least reduce to a minimum, the risk of loss through price changes; and by reason of the competition with other elevator companies they do pay the farmers right up to the market on all their purchases.

If the Futures Market was not available and they had no means of making sales practically simultaneously with their

purchases, the risk of price changes would be serious and much lower prices would have to be paid to the farmer.

Financing the Crop

There is one other important function which is performed by the Futures Market and which is a vital necessity to all elevator companies and, indirectly, to the farmer himself.

That function is the confidence which it creates in the minds of all bankers who are called upon to make loans on the security of grain and grain documents.

First Capital Expenditure

The first money which an elevator company expend out of their own funds is used in building or purchasing elevators. This money they cannot get back for any other purpose so long as they continue to own the elevators.

The balance of their own funds is required to pay for labour, gas, oil, repairs, etc., and to pay in part for grain which they purchase from farmers.

Loans from Banks

But even in the poorest of crop years it is a regular, recognized part of their business that elevator companies shall borrow from the banks more or less continuously throughout the crop year.

By this means they are able to keep buying farmers' grain freely so long as farmers desire to sell, and there is room in the elevators.

Most elevator companies own a "line," as it is called, of elevators, situated at many scattered points in the three Western provinces, and the extent to which they borrow money from the banks depends largely on the size of the crop, the price of the grain, and the number of elevators they operate.

Let us take, for example, an elevator company which owns and operates, say, fifty elevators at as many different points. Taking the cost of each of these elevators at, say, $10,000.00, this means an original outlay of $500,000.00.

The usual capacity of a country elevator is around thirty thousand bushels of wheat. Unless some of these elevators are located in a dry area, it would seem to be a reasonable estimate that for the greater part of a normal crop year each would have

in its bins at least half of its capacity, say, fifteen thousand bushels of purchased wheat. There will probably be other grains, but let us confine ourselves to wheat for the purpose of this example.

In fifty elevators this would mean a total of seven hundred and fifty thousand bushels of wheat, all paid for.

If, in addition, each elevator agent has shipped out a few cars to the Head of the Lakes, say 5,000 bushels, but which have not reached their destination, this would mean a further two hundred and fifty thousand bushels of wheat also paid for.

This total of one million bushels of wheat at a low average cost at the country point of 70c per bushel represents $700,000.00, some of which has undoubtedly been borrowed from the banks. The chances are that at some time during the year the amount borrowed will be more, and at other times less, and certainly if the price were higher the borrowings would be greater.

In citing this example no reference to any particular elevator company is intended, and any similarity with any existing elevator company is, as the fiction writers say, entirely coincidental.

Reasons for Confidence

Why do elevator companies rely so confidently on their ability to borrow from the banks as required, and why are the banks so willing to lend the money? Here are the reasons.

Among all the functions of a chartered bank one of the most important is to stimulate business by lending money.

In doing so their trusteeship of public and private funds demands that they scrutinize carefully not only the business integrity of the borrower, but the value of such securities as he may deposit with the bank, and, what is still more important, the ease or difficulty with which such securities can be sold should that become necessary in the event of the borrower, for any reason, being unable to pay off the loan.

Liquidity of Grain

When securities are easily saleable at or near existing market value they are described as "liquid", and the extent to which they are "liquid" has a vital bearing on the amount that can be borrowed, and also the rate of interest.

This is where the value of the Futures Market comes in.

Bankers know that every bushel of grain purchased from farmers at country points is almost simultaneously "hedged" by the elevator companies making sales of equivalent amounts of grain futures in the Futures Market.

Bank Loans Safe

Bankers know, therefore, that through the facilities provided by the Exchange for making delivery of the grain against these sales made in the Futures Market, their loans are not in jeopardy, and they have no hesitation in making the loans required.

It may be confidently said, therefore, that there is no class of security which, from a banker's point of view, is more "liquid", more easily realizable, and safer, than grain and grain documents.

Adjusting to Lower Prices

But it may be asked, if the banks have made loans calculated, say, at 85c per bushel on wheat when the price of wheat was $1.00 per bushel, what happens if the price declines to, say, 70c per bushel?

It has already been explained that when elevator companies have made sales of Wheat Futures in the Futures Market they register their sales in the Clearing House.

If the price of Wheat Futures in the Futures Market declines, the companies are entitled to withdraw from the Clearing House the amount of that decline figured on the amount of their sales. *

If, therefore, they had sold Wheat Futures at $1.00 per bushel and the price in the Futures Market declines to 70c per bushel, they withdraw from the Clearing House this difference of 30c per bushel on the amount sold.

This 30c per bushel is then paid into their banks in reduction of their loans from the banks, so that although the value of the grain security has declined 30c per bushel the bank's position is not affected, and its confidence is justified.

Adjusting to Higher Prices

On the other hand, should the price advance, elevator companies must deposit with the Clearing House the amount of the advance.

The bank promptly increases the amount of the loan to the elevator companies to enable them to make this payment to the Clearing House. It does so willingly because the value of the

* *See page 59.*

actual grain has correspondingly advanced. The bank's position, therefore, is again not affected, and again confidence in the Futures Market is justified.

Benefit to Farmer

The benefit to the farmer is considerable and undeniable.

The comparative freedom with which the elevator companies are able to borrow money from the banks on grain securities provides them with funds which enable them to purchase at the market price, on demand by the farmer, any grain which he desires to sell at any time and to pay cash for it.

If, however, there were no Futures Market, and, because of the risk of a decline in price before the grain could be sold and turned into cash, the banks were to consider grain as a doubtful security against loans, the ability of the elevator agents to pay cash for grain would be drastically curtailed.

If there were no Futures Market loans would not be so freely obtainable and elevator companies (pool elevators included) might, because of large unsold stocks of grain, be forced to cease buying from farmers until they could make sales of grain previously purchased and receive the cash to enable them to resume buying.

If there were no Futures Market it seems obvious that the banks would put a much lower loan value on grain stocks and the elevator companies would be compelled to pay a correspondingly lower price to farmers at country points.

Chapter Four

EXPORTERS, SHIPPERS, MILLERS, PROCESSORS and the FUTURES MARKET

The use of the Futures Market by exporters has two main objectives, one of which operates in exactly the reverse manner to that of the elevator companies.

Elevator companies **sell** Wheat Futures in the Futures Market as hedges against their daily **purchases** of wheat from farmers.

Exporters **buy** Wheat Futures in the Futures Market as hedges against their **sales** of wheat to overseas or other customers.

The meaning of the term "hedge" has already been explained. *

Consistent versus Arbitrary Buying

Elevator companies can rely on purchasing wheat daily from farmers and can usually form an approximate idea of the quantity. They are, therefore, able to make sales of Wheat Futures equivalent in amount to their purchases, and to make these sales practically at the same time as these purchases.

Exporters, on the other hand, never know when their foreign customers are likely to be actual buyers of wheat nor how much they are likely to take.

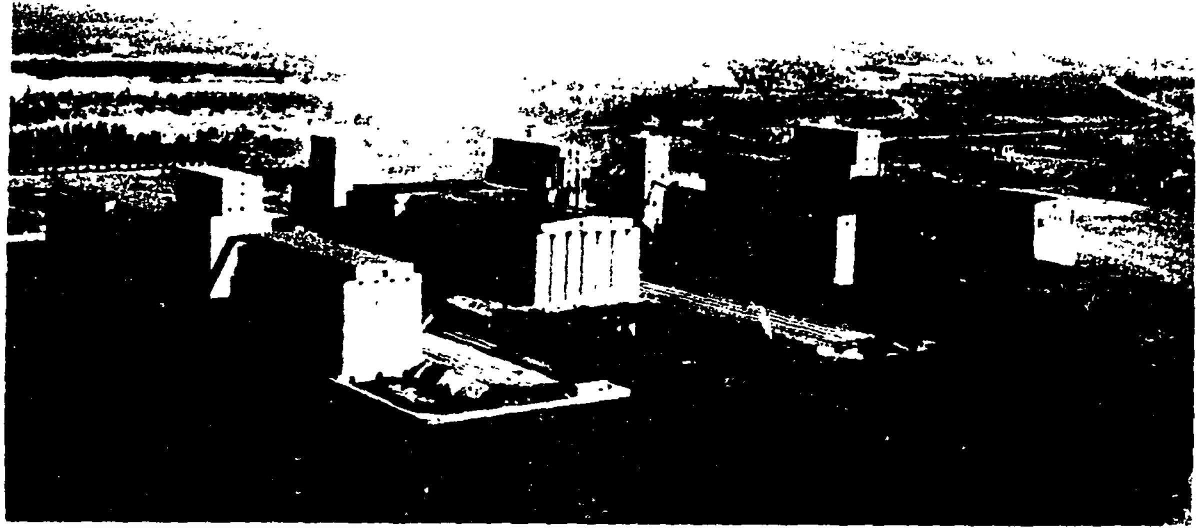
Elevator companies will buy wheat from farmers on demand at any time, because they know they can sell Wheat Futures as quickly as they buy.

The foreign customer is not so accommodating. He chooses his own time to buy, and the exporter has to await his pleasure.

Overnight Price Change Risk

Foreign buyers prefer to trade in the currency of their own country and, like Western farmers, they want an actual price. If after making purchases they want to hedge such purchases by making sales of Wheat Futures, they often prefer to do so in the Futures Market of their own country such as Liverpool, Rotterdam, etc.

* *See page 9.*



Terminal Elevators at Port Arthur

A Canadian exporter, therefore, in making daily cable offers to his overseas buyers, has to make up his mind in advance whether he will own (or be "long" in trade language) either wheat or Wheat Futures, or both, in anticipation of a sale to his foreign customer or whether he will wait and see if a sale takes place before buying enough Wheat Futures to meet these sales.

Foreign markets open and function several hours before the Winnipeg Market opens, and foreign buyers have that much more time in which to make up their minds whether or not to accept exporters' overnight cable offers.

An exporter knows, therefore, that should the Liverpool market advance during these several hours all his cable offers to the United Kingdom will, in all probability, be accepted, but if demand in the United Kingdom is slow, very likely none will be accepted.

Nice Problem

The exporter, therefore, has a nice problem on his hands, the effective handling of which calls for that keen and well-balanced judgment which is only gained by experience.

While his risk of price changes is, therefore, much greater than that of the elevator company, it does not weaken his confidence in the value and effectiveness of the Futures Market.

His experience tells him that he can so rely on the Futures Market that his overnight cable offers can be made with safety based at a fraction of a cent above the closing price of the Wheat Future of that day.

If his overnight sales are for a greater number of bushels than he owns he feels he will have no difficulty in purchasing at the opening of the market a sufficient amount of Wheat Futures to balance his sales.

If, on the other hand, there are no overnight sales, he is equally satisfied that he can sell out at the opening of the market any Wheat Futures he may have bought in anticipation of sales that did not materialize.

In either of these contingencies he feels reasonably sure of being able to buy or sell Wheat Futures at or within a fraction of a cent of the previous day's close.

Wheat Futures or Actual Wheat

Why, it may be asked, does the exporter choose to buy Wheat Futures instead of the actual grade he has sold?

The main reason is that he can buy Wheat Futures almost instantly, usually within a few seconds, while, on the other hand to accumulate sufficient of the grade of actual wheat sold might require several hours, or longer if that grade was in limited supply.

It will be remembered that it is the practice of the elevator companies to sell Wheat Futures as a hedge against their daily purchases of wheat from farmers. In view of their obligations to the Clearing House by reason of these sales of Wheat Futures elevator companies are not free to sell the grade desired by the exporter except "basis exchange of Futures."

For this additional reason, therefore, the exporter chooses to buy Wheat Futures, really because he cannot buy anything else.

Sales from Eastern Stocks

There is another reason why the exporter buys Wheat Futures against his sales. He may already have bought the cash wheat but have it hedged by sales of Wheat Futures just as the elevator companies do when they buy wheat from farmers.

"Cash Wheat" is the trade term applied to wheat in commercial channels, i.e. after it has been delivered by the farmer to the country elevator or loaded by him over the platform.

It is an established practice among exporters to ship wheat from the Head of the Lakes to ports in Eastern Canada and Eastern United States, so as to have it nearer to or at the seaboard, and in more favourable position to effect export sales.

This frequently runs into millions of bushels and no exporter would consider it sound business policy to purchase and ship this wheat unhedged. His banker also would have very definite views about that.

What happens is that the exporter, when taking over cash wheat at the Head of the Lakes by purchase from elevator companies, simultaneously sells them an equivalent amount of hedges and assumes their obligations to the Clearing House.

Therefore if the sales of wheat to foreign customers are made from stocks of wheat previously moved to Eastern Canada

Eastern United States and already hedged, all the exporter has to do is to purchase the necessary amount of Wheat Futures thereby removing the hedges. He already has the cash wheat.

"Out of Position" Wheat

It may be asked at this point, what is the position of the exporter who owns wheat which has been shipped to ports in Eastern Canada and Eastern United States and which is hedged in the Winnipeg Futures Market, in view of the fact that such wheat cannot be delivered through the Clearing House on his hedges (i.e., contracts of sale of Wheat Futures) since it is not in terminals at the Head of the Lakes?

This "out of position" wheat, as it is called, is certainly no more deliverable through the Clearing House than are the non-deliverable or "off" grades elsewhere referred to. *

Like the elevator companies, exporters are fully alive to their responsibilities on their contracts of sales of Wheat Futures. They, therefore, avoid carrying hedges of "out of position" wheat in nearby or current Futures trading months. For instance in March or April their hedges of such wheat are likely to be in the "July" Future, not the "May" Future

It is axiomatic for exporters to carry hedges in later trading months and the necessary switching of hedges to these later trading months is carried out in ample time.

The method of switching hedges from one trading month to another has already been explained. †

Sales for Distant Shipment

Purchase of Wheat Futures against export sales has also definite advantage in the case of sales made for shipment some considerable time ahead.

It is sound business policy, not only from an exporter's point of view as a salesman, but also in the farmer's own interests, that an exporter should be able to sell when a customer is ready to buy. Otherwise the buyer goes elsewhere.

It is not an uncommon thing for exporters to be selling wheat to foreign customers in January for shipment in June, or to be making sales in October for shipment in February.

* *See page 21.*
† *See page 24.*

But it is seldom practicable to purchase actual wheat from elevator companies to be delivered some months ahead. For obvious reasons, financial and otherwise, elevator companies prefer to sell for immediate or nearby delivery instead of contracting to deliver a particular grade or grades at some distant date.

On the other hand it is simplicity itself for an exporter, when making sales in January for shipment in June, to purchase May Wheat Futures against his sales and to choose his own time for exchanging his May Wheat Futures for the actual grade of wheat sold.

Daily Cable Offers

Another point to be noted is that exporters are cabling offers of wheat to foreign customers on every business day in the year, and these offers are not confined to one grade but often include offers of several grades of wheat.

They cannot be sure that cable acceptances of their offers will be confined to one grade, nor what these grades will be. But in the event of unanticipated acceptances being received the first thing to be done is to purchase an equivalent amount of Wheat Futures, which they can later exchange for cash wheat.

Counter Bids

This is even more important when a foreign customer wants to buy at a lower price and makes what is called a "counterbid" during trading hours on the Winnipeg Grain Exchange. This calls for an immediate answer, since there is no time for extended investigation.

A "counterbid" is usually an offer by a customer to buy at a price lower than that at which the exporter had offered to sell.

The Futures Market solves the problem. Whether or not the counterbid can be accepted usually depends on the price at which the Wheat Future is trading when the counterbid is received.

If the bid is too low a quick cable to that effect is sent, but if the bid is workable the Wheat Futures can be bought instantly and an immediate cable reply completes the sale.

This is the only case in which the exporter does not take the risk of price changes, and obviously it is only likely to happen in a declining market.

But in every instance the ease and rapidity with which exporters can buy Wheat Futures play by far the major part in effecting export sales.

Other Shippers

In addition to the exporters there are other shippers who sell wheat to local mills, processors, and stock feeders in Eastern Canada.

They follow the same procedure as do the exporters whether they sell in cargo quantities or in carlots. Such sales may be made out of stocks at the Head of the Lakes or from wheat previously shipped across the Lakes to distributing points in Eastern Canada.

The use of the Futures Market is still the basis on which all this business is conducted.

Some customers in Eastern Canada prefer to purchase at a definite price (or "flat" in trade language) as do foreign buyers. Some, on the other hand, find it necessary to carry stocks unsold in anticipation of sales, as does any storekeeper, and they prefer to keep such stocks hedged in the Wheat Futures Market, buying back the hedges as they make sales.

Millers and Processors

The use of the Futures Market by millers and other processors is also very similar to that of exporters and shippers.

Flour is sold both for export and for domestic consumption.

Some flour is being sold to domestic customers every business day in the year but sales for export are not a daily occurrence.

Millers, therefore, have to carry large unsold stocks of both flour and wheat, and it would be a highly speculative risk if there were no Wheat Futures sold as hedges against these stocks.

Flour, of course, is simply wheat in another form, each barrel of flour being equivalent to about four and two-thirds bushels of wheat. But wheat cannot be turned into flour at short notice; hence the necessity for always having unsold flour on hand to meet immediate demand.

When the millers buy wheat from the elevator companies they instantly hedge it by selling an equivalent amount of Wheat Futures which they repurchase when they sell flour.

If the price of wheat afterwards advances materially, the price of flour will also advance, so that as long as the miller regulates his price of flour by the rise and fall of the Futures Market, and keeps his sales of Wheat Futures (his hedges) balanced with his stocks of unsold wheat and flour, he can devote his attention to milling wheat into flour and selling flour.

Switching Grades

Occasionally a miller finds that he has a larger stock of some grade, let us say Two Northern, than he actually needs for the time being and he decides to trade it for another grade of which his stocks are short, possibly One Northern.

The Futures Market is of immediate assistance to him because the buyer of the surplus grade—Two Northern—is seldom the seller of the grade wanted—One Northern.

The Two Northern is possibly in an Eastern Mill elevator and the buyer likely an exporter, while the seller of the One Northern is almost certain to be an elevator company selling from their stocks at the Head of the Lakes.

In the case of Two Northern which he sells, he **purchases** in exchange an equivalent amount of Wheat Futures, and in the case of the One Northern which he buys, he **sells** in exchange an equal amount of Wheat Futures. Obviously the purchase and sale of the Wheat Futures balance one another out in the Clearing House.

In actual fact, therefore, he has sold a quantity of Two Northern and bought an equal amount of One Northern although the switch was made with different people.

Millers with Country Elevators

Some millers have elevators at country points and it might be argued that the daily purchases of wheat from farmers at country points could be offset against daily sales of flour. But it can safely be said that these do not balance from day to day.

Such millers find it safer and sounder to let the elevator department look after their hedging sales themselves, without regard to flour sales, and to allow the flour department to look after their hedging purchases. Their representative on the floor of the Exchange could offset the one against the other and undoubtedly does, if the orders reach him simultaneously. Other

wise he buys or sells Wheat Futures as he receives the orders to buy or sell. Consequently such a miller may be buying and selling Wheat Futures on the same day but not at the same moment.

This, of course, does not affect his merchandising operations. It is just another instance of the value of the Futures Market, this time to the miller.

Movement other than through Head of Lakes

Nothing has been said regarding wheat moving through Duluth or the Pacific Coast, or Churchill, or even to Interior elevators or mills. The story has been confined to wheat moving through the Head of the Lakes.

But the wheat that moves through these other channels referred to is merchandised either for export or for domestic use on exactly the same system as that moving through Fort William and Port Arthur.

Hedging sales on such wheat by elevator companies and hedging purchases and sales by exporters, millers, and others are concentrated in the Winnipeg Futures Market in the same way as in the case of wheat moving through the Head of the Lakes.

Without that market everything would be chaos.

Facility of Movement

It is surely obvious that by reason of the reduction to a minimum of the risk of price changes provided by the use of the Futures Market, the movement and sale of Canadian wheat is greatly facilitated.

Exporters, shippers, millers, and processors, have no hesitation in transporting unsold millions of bushels of wheat to points in Eastern Canada and the Eastern United States more favourable for sale. This, by the way, becomes a matter of vital importance when supplies of wheat are abundant and the utilization of elevator space east of the Head of the Lakes essential.

Low Margin of Profit

Relying on the safety ensured by the use of the Futures Market, competition among these merchandisers has become so keen that operating costs and profits have been reduced to a decidedly low level.

Exporters, in making sales, have to charter lake freight, pay for the actual wheat and have it loaded out, cover marine and outturn insurance on the lakes, arrange for space in the Eastern elevator, charter ocean freight and have the wheat loaded out again, cover ocean marine and outturn insurance, pay all these charges, arrange international exchange and finance the entire transaction until the buyer pays the drafts in London, and all this for a fraction of a cent per bushel.

It is doubtful if millions of dollars worth of any other commodity (unless assisted by a similar Futures Market) is transported five thousand miles, with exporters undertaking all the obligations named, for such small return.

The Futures Market is the foundation upon which all this rests

Chapter Five

TRADERS, INVESTORS, SPECULATORS and the FUTURES MARKET

No review of the Futures Market can overlook the part played therein by traders, investors and speculators.

It has been pointed out that the elevator companies are selling Wheat Futures in the Futures Market on every business day in the year. The volume of that selling is equivalent to the amount of wheat they purchase daily from farmers.

On the other hand the purchases of Wheat Futures by exporters and other merchandisers and processors are definitely intermittent. On some days they exceed the sales by the elevator companies, on others they are less than these sales.

Cushion or Shock Absorber

Trading by traders, investors, and speculators has frequently been described as the cushion which absorbs the shocks of excess sales by the elevator companies or the excess purchases by exporters and other merchandisers and processors.

If it were not for these traders, investors, and speculators there would be days on which there would not be enough buying by exporters, millers and other merchandisers to take the hedging sales of the elevator companies against wheat which they had purchased from farmers.

The risk of not being able to sell Futures as hedges against purchases from farmers would be that much greater and the elevator companies would be under the necessity of paying lower prices to farmers because of that risk.

Such trading does not prevent the rise and fall of prices but it does induce some measure of price stability and does much to prevent wide swings in prices which would otherwise be inevitable and, in the opinion of most people, quite illogical.

How does this work? It all hangs very largely on a full, proper, understanding of the meaning of the word "parity" as it is applied to wheat prices.

What is "Parity"?

During the past sixty years the United Kingdom has been the chief import country towards which much of the export wheat

surpluses have tended to gravitate especially from the Big Four exporting countries, Canada, United States, Australia and Argentina.

The British miller therefore has developed the technique of blending wheat to a remarkable degree. For strength he buys Canadian wheat, and, in a lesser degree, American Winters and Argentines. For filling he uses home grown wheat and Australians with occasional wheats from other countries as these are offered.

His chief concern is to maintain a uniform standard of quality so that no matter how he may change his grist, the housewife and the baker will recognize the same consistency, the same handling in the dough, the same colour in the flour and the bread, that they have been accustomed to.

At the same time he has to watch closely the prices of the various wheats he requires for his mix.

If Canadians get too high in price compared with American Winters or Argentines he reduces the percentage of Canadians in his grist in favour of one or both of the other two and vice versa.

If Australians get too high he looks around for similar substitute wheats, going back to Australians when the price, through falling off in demand, adjusts itself.

The relation in the milling value of one kind of wheat to that of another kind is known as its "parity."

"Parity" and Wheat Futures

This principle of "parity" is now accepted by traders, investors, and speculators all over the world and plays an important part in their operations in the leading Futures Markets especially Liverpool, Chicago, Winnipeg and Buenos Aires.

In normal times when these operators, some of whom are quite active, see wheat prices in one Futures Market get below their parity, they buy Wheat Futures in that market and sell Wheat Futures in another market in which prices are above parity.

This is called inter-market trading or "spreading"—in Liverpool it is called "straddling"—and it frequently runs into millions of bushels.

Value of "Spreading"

It is one of the principal correctives to wheat prices getting out of line with their parity. Its effect on prices in the Winnipeg Futures Market may be briefly summarized.

It provides sound and active competition to foreign buyers and puts an obstacle in the way of their getting Canadian wheat below its parity. Foreign buyers know this full well and govern their buying policy accordingly.

On the other hand it acts as a check to a general wave of over-enthusiasm in favor of higher prices which in the opinion of these traders is not warranted and which is keeping foreign customers for Canadian wheat out of the market.

Parity and Speculation

Investors also who consider that wheat, as a commodity, is too low in price, and speculators who are actuated by the same idea both add their weight to correcting an unduly depressed level of prices.

It should be realized that at least 85% of the operations by speculators as taken from the records of Grain Commission firms in Winnipeg, enter the market on the buying side.

It is true that these speculators have to sell out at some time or another, and that sudden unexpected declines in price take place, but there are always other speculators waiting to buy on these declines as they take place, including speculators who previously had been selling out as the market had been advancing.

While no actual figures are available, it is generally believed by those who keep a close watch on investment and speculative trading that operators of this kind in normal times carry (or are "long") in the aggregate anything from fifty to one hundred and fifty millions of bushels of Wheat Futures throughout each crop year.

This is quite a load to take off the shoulders of the farmers.

Speculation and Export Sales

There is another point which should be considered.

In normal times, when the carry-over at July 31st gets down to small proportions, Canada is faced with the problem of how

to hold its trade in wheat with foreign customers for Fall shipments, in competition with American Winter wheat, which is harvested in June and July, two months earlier than crops in Western Canada are harvested.

Unless there are evidences of serious crop damage in the United States, it is not uncommon for the U.S. Exporters to be offering new crop Winters in May and June for Fall shipment to Europe. As hedges against these sales, U.S. exporters usually buy July and September Wheat Futures in Chicago.

If Canadian exporters were not in a position to offer new crop Canadians until crops in Western Canada were harvested, foreign buyers would have bought a large share of their Fall requirements elsewhere by the time Canada was ready to sell.

To meet this difficulty the Winnipeg Grain Exchange provides for trading in October Wheat Futures as early in the year as January. Trading in this distant Future usually opens slowly but gradually increases in volume as traders, investors and speculators take an active interest in the Futures. Spreading with other Futures trading months and with other Futures Markets expands, and in course of time trading increases and becomes quite free.

The operations of these traders, investors and speculators provide the trading in October (and later December) Wheat Futures which enables the exporter to purchase hedges against any sales of Canadian wheat, which he is able to make to foreign customers for shipment in the Fall months in competition with U.S. offerings of American Winter wheat, weeks and sometimes months before the elevator companies begin to make hedging sales against purchases of new crop Canadian wheat from farmers.

Short-Selling

It may be said that this is short-selling in anticipation of being able to buy at a lower price at a later date.

It is not necessarily so. It may be selling of October Futures against a purchase of December Futures, if in the trader's opinion the October Futures are too high in price compared with December.

It may be selling October Futures against purchases of September or December Wheat Futures in Chicago, if in his

opinion Winnipeg Wheat Futures are above their parity compared with Chicago.

It may be speculative short-selling, but whatever the reasons it has two important effects.

It enables Canada to get its share of the buying by its foreign customers when they are in the mood to buy.

Equally important is the fact that it provides a definite buyer for hedges of new crop Canadians when the farmers start selling in the Fall. Note carefully that the overseas customer does not have to buy—the painful past proves that—but the speculator who sells short **must buy.**

Basic Essentials

The value of the four leading Wheat Futures Markets—Liverpool, Chicago, Winnipeg and Buenos Aires rests on two basic essentials.

Firstly, it rests on the fact that delivery of the actual wheat is contemplated in every transaction. Every trader knows this and the only way he can avoid making or taking delivery of the actual wheat is by trading (buying in, or selling out, as the case may be) and passing on this responsibility to someone else. But the actual wheat is back of the market; somebody has to make delivery and somebody has to take delivery of it.

Secondly the trading must be broad and active. Exporters, millers, and elevator companies as well as traders, investors, and speculators must have confidence that they will be able to buy or sell close to quoted prices at any moment.

There have been instances, on both sides of the Atlantic, of Futures Markets in which trading shrank to small dimensions practically local in character. The result has been that merchandisers, who desired to place hedges against sales or purchasers of actual wheat, transferred their hedging operations to other markets where the trading was sufficiently free and liberal to enable them to buy in or sell out their hedges promptly, when desired, and at the current market prices.

Winnipeg, in normal times, possesses these two basic characteristics in marked degree. By far the largest percentage of each year's wheat crop of Western Canada actually passes

through Winnipeg to its delivery base at the Head of the Lakes and the sale and purchase of practically every bushel passes through the medium of the Wheat Futures Market.

Democratic Opinion

Thousands of traders of all kinds, not only in Canada, but from all over the world, express in the Futures Market their opinion of the value of Canadian wheat, not from an academic or theoretical standpoint, but by backing these opinions in actual trading.

This mass opinion is a more democratic form of expression than is the election of members to a Dominion Parliament, and it constitutes a very real yardstick for establishing values, a barometer which responds sensitively, quickly, and accurately to world conditions.

Chapter Six

COMMISSION MERCHANTS, BROKERS and the FUTURES MARKET

Considerable confusion exists in the minds of many people regarding the functions of grain commission merchants and grain brokers, but the difference between them is quite sharp and clear.

Brokers, with one exception,* act strictly in transactions between resident members, and none of them handles grain documents or cash.

A grain commission merchant acts on behalf of non-members or non-resident members, and occasionally on behalf of resident members. He handles both documents and cash on his client's behalf.

Grain Commission Merchant

The grain commission merchant, in every trade he makes, has a dual responsibility. He is responsible to his client for the correct and efficient execution of his orders, and the conduct of business in his behalf. He is also responsible to his fellow members.

The Exchange and its members regard him as a principal in any contracts of sale or purchase in the Futures Market he may make on behalf of a client. Neither the Exchange nor the Clearing House recognizes a client or other third party to such contracts.

The Exchange, however, by By-laws, Rules and Regulations insists that its members, when transacting business on behalf of clients, shall do so faithfully and honourably, and in accordance with the highest standards of business ethics.

No member is allowed to buy for his own account any Wheat Futures which a client may instruct him to sell in the Futures Market or vice versa. A trade must be made with another member of the Exchange. This is not only sound business ethics, but is good law.

Every transaction is registered with the Clearing House by both buyer and seller. The Exchange also keeps a minute-to-minute record of price changes. There is no difficulty, therefore, in verifying the authenticity of any trade.

* *See page 56—C.I.F. Brokers.*

Grain Brokers

Grain brokers, however, are in an entirely different category.

There are three kinds of brokers, all of whom simply act as intermediaries between principals.

These three types are described as "Futures brokers," "Cash grain brokers" and "C.I.F. brokers." When, through the services of a broker, the terms of a purchase and sale are settled, the completion of the transaction is then carried out direct between buyer and seller.

Futures Brokers

Futures brokers, or as they are usually called in the trade "pit brokers," execute orders received from resident members of the Exchange to buy or sell Grain Futures in the Futures Market. The Rules of the Exchange insist that these be made openly in the wheat pit, without discrimination as to who is the second party to the trade.

That part of the floor of the Grain Exchange in which the Futures Market is held daily is called the "pit". It is so named because it is in the form of an actagon, rising in tiers from the centre outwards, so that every trader can see each other trader. Hence the name "pit broker."

The chief value of a pit broker lies in the fact that he is buying and selling Futures practically all the time. The expert pit broker has a hair-trigger touch on trading values at the time he gets an order and if he is called upon to execute a comparatively large purchase or sale, his skill and his sense of atmosphere enable him to get the best results for his client.

Switching Trades

This is important in "spreading," i.e., switching hedges or other trades from one Futures month to another, especially when no other broker has an order to do the reverse.

For example, if an elevator company desires to switch their hedges from December to May, they must buy December and sell May. But if no other broker has an order to sell December and buy May, it becomes necessary to "lift a leg" as it is called. That is to say that the broker has to decide whether to buy December and then sell May, or to sell May before he buys December. This is where his keen sense of trading values enables him to decide on the best procedure to follow.

This necessity to "lift a leg" must not be confused with speculation. The risk involved is slight probably only for the fraction of a minute, and is done gradually and in relatively small amounts at a time.

Inter-Market Spreading

In spreading Grain Futures in the Winnipeg Futures Market with Grain Futures in some other market, at stipulated differences, he clearly cannot trade in both at exactly the same moment. Obviously, therefore, he must "lift a leg," as prices in the one market may get out of line while his order to buy or sell in the other market is in transmission on the wire. This, therefore demands expert handling.

Clearing House Procedure

A pit broker is not required to be a member of the Clearing House

If he is not a member he does not register trades with the Clearing House for his clients. The registration is done by his clients and not by the broker.

A pit broker can be a member of the Clearing House. If, however, he registers in his own name with the Clearing House, and carries in his own books any trades executed for account of clients, whether these are members of the Clearing House or not, he does so as a grain commission merchant and the commission he charges for his services is higher.

Brokerage Charges

Elevator companies, exporters and other merchandisers who have their own representatives in the pit, find it advantageous at times to use the services of a pit broker. Whether the cost of trading in Grain Futures consists of employees' salary or of pit brokerage, which is 25c per 1000 bushels, it is so small that it is absorbed in general expense.

More Than One Category

It should be understood that a member of the Exchange can belong to more than one category in trading in grain or Grain Futures, so long as the Council and his fellow-members are aware of this.

Trading Cards

All trades in Grain Futures are recorded on trading cards, one side being reserved for purchases and the other for sales. They are subsequently transferred to clearing sheets which are then registered with the Clearing House.

Examples of a trading card and clearing sheets will be found on Pages 66 to 71.

Cash Grain Brokers

Cash grain brokers act as intermediaries between resident buyers and sellers of specified grades of grain.

All Wheat Passes Through the Medium of the Futures Market

Practically every bushel of wheat which is sold by farmers in Western Canada each year passes through the medium of the Futures Market.

Every bushel which the elevator companies purchase from farmers is promptly hedged by sales of equivalent amounts of Wheat Futures, which are then registered with the Clearing House and which call for delivery of actual wheat through the Clearing House.

Small Percentage Passes Through Clearing House

But, in practical business, only a small percentage of the deliveries of actual wheat is made through the Clearing House.

There are several sound reasons for this.

In the first place trading in Wheat Futures is confined to deliveries through the Clearing House in four months in the year, May, July, October and December,* whereas millions of bushels, although hedged by sales in one or other of these trading months, are delivered direct to buyers during the other eight months.

Secondly, sellers are only entitled to deliver through the Clearing House any of seven grades of wheat on their Futures Sales contracts,† whereas in fact all grades are confidently hedged by sales of Wheat Futures in the Futures Market.

Thirdly, buyers are regularly offering premiums in order to obtain delivery of a specified contract grade or grades, or to secure delivery at a specified time, or both, rather than wait the seller's pleasure.

* *See page 12.*

† *See page 72.*

In point of fact the grade or grades of wheat which are actually delivered through the Clearing House in fulfilment of contracts of sale of Wheat Futures, are those contract grades which are in poorest demand.

Fourthly, there are many "off" grades which are not deliverable through the Clearing House, and which can only be sold "basis exchange of Futures."

This is where the services of a Cash grain broker are found to be of value.

Multiplicity of Grades

There is a multiplicity of grades of wheat. Besides all the straight grades of Spring Wheats, Durums and Garnets, there are the rejected, toughs, damps, etc., of each straight grade.

The good Cash grain broker knows to within 1/8c per bushel the value in relation to the Futures, of every grade which is being traded in more or less regularly, and can establish quickly the value of any grade which only occasionally is offered.

A buyer is not always in the market for the same grade. He may want only One Northern one day, and only Four Northern the next, or he may want several grades.

Trading All the Time

Unless a buyer or seller is trading in all grades at all times, he cannot have an accurate idea of what any grade is worth. Buyers and sellers the world over are seldom willing to show their hands to each other. The one desires to buy as cheaply as possible, the other to get the best price he can.

Confiding in Brokers

On the Grain Exchange, buyers have no reluctance in informing Cash grain brokers of what they want to buy, nor sellers what they have to offer, one reason alone being that, except in very rare occasions, the names of buyer and seller are not disclosed to each other until a sale is made.

The Cash grain broker, therefore, has a broad and accurate picture of what is available, and what is wanted, and can indicate accurately what any grade is worth in relation to the Wheat Future quotations.

Form 15—5M—2-42

BROKERS BUSHELS 10.000

ERNEST S. PARKER
GRAIN BROKER
Phone 93 394
GRAIN EXCHANGE

O Nº 3161

Winnipeg, August 8 1942

I have this day sold to Norris Grain Co.

for account of Canadian Wheat Board

10.000 3° @ 82½

Spot

In store in a regular Elevator at Fort William or Port Arthur

Delivery Immediate

Basis Fort William and or Port Arthur Freights

Futures Exchange 10 October Wheat @ 90

Sold at 9:35a o'clock

ERNEST S. PARKER

Seller Pays Brokerage

Per P.

Accepted

Cash Grain Broker's Note

Trading Direct

In some isolated cases trading in cash grain is done direct between buyer and seller, the latter thereby avoiding the brokerage charge. In the main, however, sellers find that it pays to use the services of the Cash grain broker. Any direct selling is just riding on the crest of the wave created by the trading which is done through the medium of the brokers.

Use of Futures

Practically every sale of wheat made by a Cash grain broker is made "basis the Future" or "basis exchange of Futures." In those isolated cases where farmers sell their wheat "flat" after being unloaded in terminals at the Head of the Lakes, the basis of sale is established by the buyer selling an equivalent amount of Futures as a hedge.

Broker's Note

When the price indicated by the broker is satisfactory to both buyer and seller, he hands each of them a "Broker's Note" * giving the terms of the transaction. The transaction is then completed direct between buyer and seller; the broker's part is finished except to collect his commission of 1 16c per bushel, which, except by special agreement, is paid by the seller.

Official Closing Cash Prices

At the close of the market each business day, a committee of Cash grain brokers meets and puts on record the cash prices of the various grades, which are posted on the Exchange as the Official Closing Cash Prices.

It is the custom of some of the brokers to issue a "Spread Card" on the one side of which they show the value of each grade "basis exchange of Futures," and on the reverse side of which they show the actual "flat" prices of the various grades worked out, based on the closing price of the Future combined with spreads.

For instance on the specimen Spread Card of August 8th, 1942, given on page 53 and 54 you will notice the closing prices of the October Futures, the spread of the various grades and the actual cash prices worked out therefrom as follows:—

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* *See page 50.*

Closing Price of the October Future	*Grade*	*Spreads*	*Actual Cash Price*
Wheat 90c	1 Nor. Wheat	1¼ under October	88¾
	2 Nor. Wheat	4⅜ " "	85⅝
	3 Nor. Wheat	7½ " "	82½
	etc.		
Oats 46c	2 CW Oats	½ " "	45½
	Ex. 3 CW Oats	1½ " "	44½
	3 CW Oats	1½ " "	44½
	etc.		
Barley 60⅞c	2 CW 6 Row Barley	October Price	60⅞
	3 CW 6 Row Barley	1¾ under October	59⅛
	1 Feed Barley	4 " "	56⅞
	etc.		
Rye 54½c	2 CW Rye	1½ " "	53
	3 CW Rye	6¼ " "	48¼
	4 CW Rye	9 " "	45½
	etc.		

The important point about these Closing Cash Prices is that they are based on bids which cash grain brokers have in hand from exporters, millers, etc., at the close of the market each day.

These bids have all been made "basis exchange of Futures" and have not been made "flat", i.e., at an actual price. The "flat" price on the card is only deduced from the bids made "basis the Future" and without this relation to the Future any "flat" bids would be at considerably lower prices.

In the great majority of cases farmers' odd cars can be sold at these "flat" prices between the close of the market and the opening of the market next day, the buyers attending to their own hedges, but there is no guarantee, implied or otherwise, that this can always be done.

There are occasions when it is impossible to sell even odd cars at these "flat" prices but these instances are due to exceptional circumstances and are not of frequent occurrence.

These spreads and prices, by the way, unless otherwise stated, are always for wheat actually in the terminals at the Head of the Lakes and always include any premiums that are being paid for wheat in these terminals.

STANLEY N. JONES

WHEAT	SPOT	TOUGH	REJ'D	SMUTTY	SPROUTS	DURUM	TF.DUR	GARNET	A.R.W	CORN
1 HARD	1¼–0	3½–0								
1 NOR	1¼–	3½–	11–0	8½–0	10–0	6–0	8–0	10–0	10–0	TRACK
2*	4⅜–	7⅜–	12–	11½–	12–	6–	8–	12–	11–	3 C.W. YELLOW
3*	7½–	10–	14–	13½–	12–	8–	10–	14–	14	20% MOISTURE
4*	10⅛–	11¼–	16–	15–	14–	11–	13–			60 CENTS
5	16–	18–	19–	18–	17–	13–	15–			
6	17½–	19–	21–	20–		16–	18–			
FEED	20–	22–		22–						

TRACK DUR 6–0

OATS	SPOT	TOUGH	RYE	SPOT	BARLEY	SPOT	TOUGH	SCREENINGS
2 C.W	½–0	2–0	2 C W	1½–0	1 C.W 6 ROW	OCT	2–0	$7.75 TON
X.3 C.W	1½–	3–	3 C W	6¼–	2 C.W 6 "	OCT	2–	
3 C.W	1½–	3–	TF 2 C W	5½–	1 C.W 2 "	OCT	2–	
X.1 FEED	2–	3½–	REJ 2 C W	8–	2 C.W 2 "	OCT	2–	
1 FD	3½–	4¼–	TF 3 C W	8–	3 C.W 6 "	1¾–	4½–	
2 FD	6¼–	7¼–	4 C W	9–	1 FEED	4–	5–	
3 FD	8–	9–	ERGOTY	13–	2 FD	6–	7–	
					3 FD	7½–	8½–	

WINNIPEG FUTURES

TRACK	MXD GRAIN	MONTH	WHEAT	OATS	BARLEY	RYE
W 1¼–0	1 70	OCT	90	46–	60⅞	54½
O 1–0	2 44	DEC		45⅝	60¾	56aN
R 1⅛–0	3 51					
B ⅞–0						

SATURDAY AUGUST 8 1942

Spread Card — Prices Basis Exchange of Futures

PHONE **STANLEY N. JONES** 97918

CASH PRICES BASIS IN STORE FT WILLIAM PT ARTHUR

WHEAT	SPOT	TOUGH	REJ'D	SMUTTY	DUR	GARNET	A.R.W	SPTD
1 HARD	$88\frac{3}{4}$	$86\frac{1}{2}$						
1°	$88\frac{3}{4}$	$86\frac{1}{2}$	79	$81\frac{1}{2}$	84	80	80	80
2°	$85\frac{5}{8}$	$82\frac{5}{8}$	78	$78\frac{1}{2}$	84	78	79	78
3°	$82\frac{1}{2}$	80	76	$76\frac{1}{2}$	82	76	76	78
4°	$79\frac{7}{8}$	$78\frac{3}{4}$	74	75	79			76
5	74	72	71	72				73
6	$72\frac{1}{2}$	71	69	70				
FEED	70	68		68				
TRACK	$88\frac{3}{4}$				84			

CASH WHEAT CAN BE SOLD AT ABOVE PRICES ONLY IF OCTOBER WHEAT FUTURE IS EXCHANGED

OATS	SPOT	BARLEY	SPOT	RYE	SPOT
2 CW	$45\frac{1}{2}$	1 CW 6 R	$60\frac{7}{8}$	2 CW	53
X 3 CW	$44\frac{1}{2}$	2 CW 6 R	$60\frac{7}{8}$	3 CW	$48\frac{1}{4}$
3 C.W	$44\frac{1}{2}$	1 CW 2 R	$60\frac{7}{8}$	TF 2 CW	49
X-1-FD	44	2 CW 2 R	$60\frac{7}{8}$	REJ 2 CW	$46\frac{1}{2}$
1.FD	$42\frac{1}{2}$	3 CW 6 R	$59\frac{1}{8}$	TF 3 CW	$46\frac{1}{2}$
2.FD	$39\frac{3}{4}$	1 FEED	$56\frac{7}{8}$	4 CW	$45\frac{1}{2}$
3.FD	38	2 FD	$54\frac{7}{8}$	ERGOTY	$41\frac{1}{2}$
TRACK	45	3 FD	$53\frac{3}{8}$	TRACK	$53\frac{3}{8}$
		TRACK	60		

===CAR===

RECEIPTS		WINNIPEG FUTURES				
		MONTH	WHEAT	OATS	BARLEY	RYE
W	346					
O	37	OCT	90	46-	$60\frac{7}{8}$	$54\frac{1}{2}$
B	9	DEC		$45\frac{5}{8}$	$60\frac{3}{4}$	56aN
R	1					
F	5					

===AMERICAN FUTURES===

DELIVERIES		MINNEAPOLIS		OATS	BARLEY	RYE	FLAX
W	M	SEP	$110\frac{1}{4}$	$45\frac{7}{8}$	55	$60\frac{1}{2}$	$248\frac{1}{4}$
O	M	DEC	$113\frac{5}{8}$	$47\frac{7}{8}$		64	$251\frac{1}{2}$
B	M						
R	M						

	CHICAGO					CORN
	SEP	$117\frac{1}{2}$	$50\frac{3}{8}$		$64\frac{3}{8}$	$86\frac{7}{8}$
SATURDAY	DEC	$120\frac{1}{2}$	52		$68\frac{5}{8}$	$89\frac{3}{8}$
AUGUST	MAY	$124\frac{1}{2}$	54		$74\frac{3}{8}$	$93\frac{3}{4}$
8 1942						

Spread Card — Official Cash Closing Prices

As a matter of fact on that date, August 8th, 1942, all the contract grades of all grains with one exception, were trading at premiums over the delivery basis, although, also with one exception, they are all quoted at a discount under the price of the October Future of the respective grains.

How, then, is this seeming paradox to be explained? It all turns on what are called "carrying charges" and which consist of elevator storage and bank interest.

In some detail the carrying charges on each grain from August 8th to October 1st were as follows,—

	Wheat	*Oats*	*Barley*	*Rye*
Storage 1 45c per bus. per day	1.18	1.18	1.18	1.18
Interest at 3½% . . .	.45	.24	.31	.27
	1.63	1.42	1.49	1.45
Say—	1⅝c	1½c	1½c	1½c

A purchaser of One Northern on Aug. 8th at 1¼c under October, if he kept it hedged in the October Futures until October 1st would therefore find his cost ⅜c over October on that date, i.e., at a premium of ⅜c per bushel.

Two Northern if purchased at 4⅜c under October, and "carried" until October 1st would cost 2¾c under October on that date or ¼c premium over its delivery basis of 3c under.

The following table of two grades of each grain at the prices quoted on this spread card will broadly illustrate the point.

Closing Price of the October Future	*Grade*	*Spread basis the Oct. Future*	*Carrying Charges*	*Spread basis the Oct. Future on Oct. 1st*	*Delivery Basis*	*Premium*
Wheat 90c	1 Northern 3 Northern	1¼ under 7½ "	1⅝ 1⅝	⅜ over 5⅞ under	Oct. price 8 under	⅜c 2⅛c
Oats 46c	2 CW 3 CW	½ " 1½ "	1½ 1½	1 over Oct. price	Oct. price 3 under	1c 3c
Barley 60⅞c	3CW 6 Row 1 Feed	1¾ " 4 "	1½ 1½	¼ under 2½ under	2 under 4 under	1¾c 1½c
Rye 54½c	2 CW Rye 3 CW Rye	1½ " 6¼ "	1½ 1½	Oct. price 4¾ under	Oct. price 5 under	NO PREM ¼c

A reference to the list of contract grades on page 72 and a comparison with the prices on the spread card on page 53 and 54 will demonstrate the situation with regard to premiums on the other deliverable grades.

The figures, to the uninitiated, take a little working out, but to the members of the trade they are simple, and they are an important every-day feature in merchandising. At times they also play an important part in influencing spreading or switching hedges from month to month according to the significance paid to the premiums by traders.

C.I.F. Brokers

The third type of broker is called a "C.I.F. broker." He acts as an intermediary between resident and non-resident buyers and sellers of wheat shipped or to be shipped from the Head of the Lakes or Duluth to ports in Eastern Canada or Eastern United States.

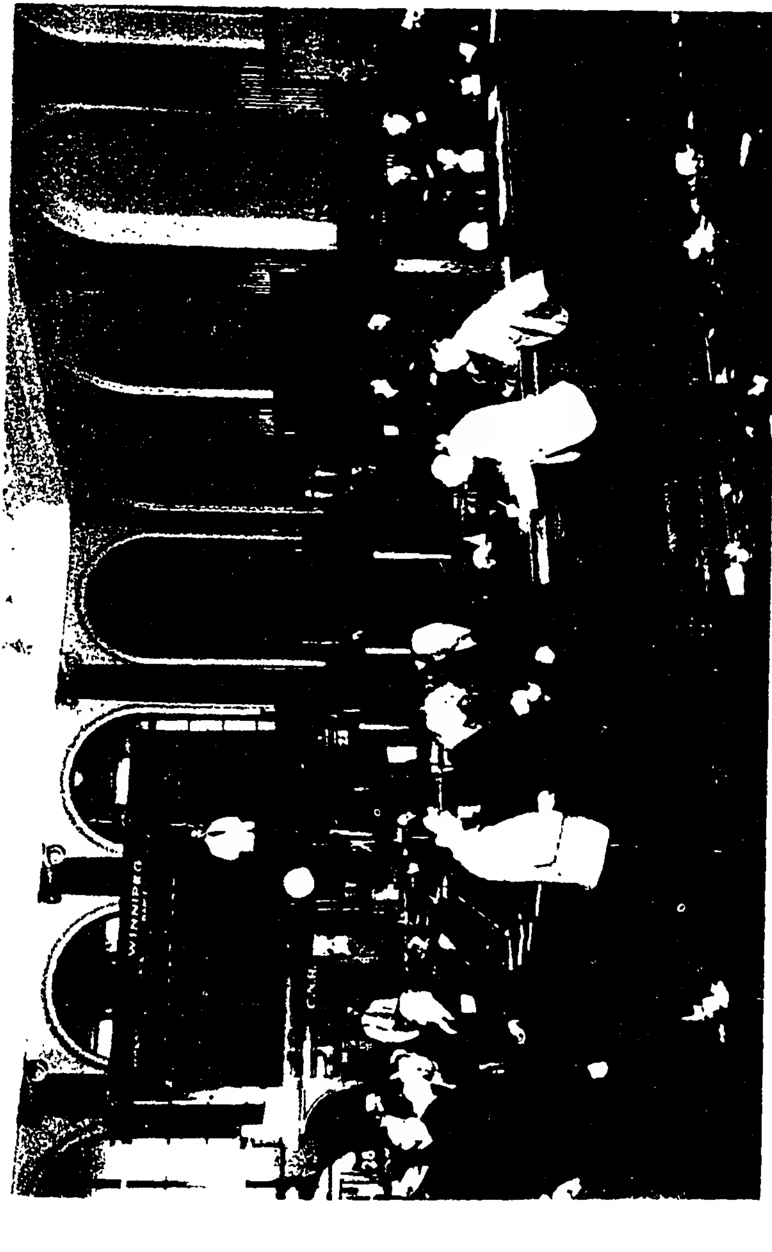
C.I.F. is a general commercial term for Cost, Insurance and Freight, and a C.I.F. price includes these three factors.

His services are in limited demand because most exporters now have their own offices at the seaboard, and it is not often that exporters either in Winnipeg or at the seaboard purchase wheat that has been shipped eastward by other exporters.

Exporters nowadays do their own shipping to Eastern ports in anticipation of export sales, and it is seldom that they make such sales of a grade of which they do not own stocks at or near the seaboard, or which they can ship from the Head of the Lakes in time to complete ocean shipment.

The number of C.I.F. brokers is, therefore, considerably less than it was some years ago.

But the sales they make on behalf of their principals are invariably made "basis exchange of Futures."



Trading Floor — Telegraph Services

Chapter Seven

THE CLEARING HOUSE and the FUTURES MARKET

The Clearing House is the short title for the Winnipeg Grain and Produce Exchange Clearing Association.

Only members of the Grain Exchange can be members of the Clearing House, but not all members of the Exchange are members of the Clearing House. Many resident members of the Exchange do not find it necessary nor advisable to be members of the Clearing House. Non-residents find it impractical to be members for obvious reasons as will appear, but only members of the Clearing House can have their trades in the Futures Market cleared daily through the Clearing House.

Clearing Trades

What is meant by "Clearing" trades?

When the Grain Exchange was instituted the original By-laws provided briefly that either party to a contract could demand that 5c per bushel margin be deposited in a chartered bank and "kept good"—i.e., maintained—based on market value until the contract had been carried out. These margins had to be deposited in joint names of buyer and seller.

This arrangement was soon found to be cumbersome and impractical in the case of contracts of purchase and sale of Futures in the Futures Market.

The Clearing House was, therefore, established to act as a common medium for depositing and keeping good such margins, instead of having them deposited and maintained in scattered chartered banks.

A new By-law was thereupon enacted by which members of the Exchange who were both members of the Clearing House could within forty-five minutes of the close of each day's trading in the Futures Market register their contracts with the Clearing House.

After satisfying itself that the registration of each contract by buyer and seller was in agreement, the Clearing House took over the responsibility of seeing that adequate margins were maintained and gave the "all clear" signal to both members. Hence the terms "Clearing House" and "Clearing Trades."

Responsibility

From this point onwards the responsibility of each member of the Clearing House is to the Clearing House and not to the member with whom the original purchase or sale was made.

In order to ensure that this responsibility will be lived up to, the Clearing House demands that each contract shall be margined to each days close.

Example

Let us take an example.

One member during a session sells another member 10,000 bushels of October Wheat Futures at 91c, and, at the close of the market October Wheat Futures traded at 90c.

Both buyer and seller register the purchase and sale with the Clearing House, but as the market has declined 1c per bushel since the contract was made, the purchaser has to pay 1c per bushel into the Clearing House in order to keep his financial standing in the Clearing House at the same level as it was before he made this contract.

On the other hand by reason of the decline in the market, the seller of the October Future at 91c finds his standing in the Clearing House improved beyond the requirements of the Clearing House by 1c per bushel, and he accordingly withdraws this amount from the Clearing House thereby maintaining his financial standing in the Clearing House on the same level as it was before he made the contract.

Should the market the next day close at 91½c (a recovery of 1½c per bushel) the procedure is reversed, the seller depositing 1½c per bushel with the Clearing House while the purchaser withdraws 1½c per bushel and so on from day to day so long as the trades remain open.

Balanced Results

The net results are:—

1. The total number of open purchases equals the total number of open sales registered in the Clearing House and they keep balanced all the time.
2. The cash deposits paid into the Clearing House each day are exactly equal to the withdrawals.
3. The standing of each member of the Clearing House remains continuously on the same even level.

Not the Same as Profit and Loss

This must not be confused with "profit" and "loss."

In the case of elevator companies who have sold Wheat Futures as a hedge against purchases from farmers, a decline in the Futures market and a withdrawal of the amount of the decline from the Clearing House is offset by a decline in the value of the actual wheat purchased and vice versa.

In the case of exporters who have bought Wheat Futures as a hedge against sales to foreign customers, a decline in the Futures market and a deposit of the amount of the decline with the Clearing House is offset by the lower price they will pay for the actual wheat to fill their export sale and vice versa.

In the case of spreading, say with Chicago, a decline in Winnipeg will probably be offset by some decline in Chicago.

Only in the case of investors and speculators, can a rise or fall in Futures prices be reckoned profit or loss.

Interim Margin Calls

The Clearing House reserves the right to call on members to deposit margins during the session when Futures prices rise or fall sharply. It does not have to wait until the close of the market, if, in its opinion, the change in price from that of the previous day's close warrants this precautionary action.

Any member who fails to deposit the funds necessary to maintain his standing in the Clearing House or any member who fails to respond instantly to an emergency interim call is subject to summary action by the Clearing House. All his trades open in the Clearing House may be closed out by selling them out or buying them in, as the case may be, in the Futures Market.

The Clearing House is responsible to its members for the trades which it has cleared. It recognizes this responsibility and takes no chances, knowing full well that it will have to pay for any losses that might occur through the failure of any member to maintain his good standing by keeping up his margins in the Clearing House to the required level.

Volume of Trades

Naturally the buying and selling of actual wheat "basis exchange of Futures," the "switching of hedges" and "spreading" multiply enormously the registration of trades with the Clearing House.

Take for example an elementary instance:

An elevator company, on a day early in October, buys from farmers 100,000 bushels of wheat and sells 100,000 bushels of October Wheat Futures as a hedge, in the belief that they will be able to deliver this wheat at the Head of the Lakes before the end of October.

Car shortage or railway congestion upsets their plans and they find themselves unable to make delivery in October.

They accordingly switch their hedges to December by buying in 100,000 bushels of October Wheat Futures and selling 100,000 bushels of December Wheat Futures.

They manage to get this wheat to the Head of the Lakes in November and promptly sell this "basis exchange of December Futures."

The elevator company alone, therefore, in this elementary example have registered with the Clearing House the following trades:—

Original Hedge—	*SOLD*	100,000 bu. October Wheat Futures
Switched Hedges—	*BOUGHT*	100,000 bu. October Wheat Futures
	SOLD	100,000 bu. December Wheat Futures
Sold actual Wheat basis exchange of Futures.	*BOUGHT*	100,000 bu. December Wheat Futures

or four times the amount of the original number of bushels of actual Wheat involved.

Bear in mind that both ends of every trade in Futures, purchases as well as sales, are registered with the Clearing House.

Therefore, if the exporter, having registered an original purchase of 100,000 bushels October Futures as a hedge against a sale abroad, finds it advisable to switch his hedge to the December Futures, which he finally exchanges for actual wheat, another 400,000 bushels is registered with the Clearing House.

And if the foreign buyer desires to purchase the actual wheat from the exporter "basis exchange of Futures" another 200,000 bushels is registered, assuming he does not have to add to this by switching his hedge.

So that, involved in the original purchase of 100,000 bushels by the elevator company, there is registered with the Clearing House in this elementary example, ten to twelve times that amount of Wheat Futures.

To the uninformed, however, this tends to create the fallacious impression that the same wheat is being bought and sold over and over again and that the return to the farmer is thereby affected.

The fact is that these trades have no effect whatever in the price of wheat. They are all part and parcel of the original sale of Wheat Futures by the elevator company and the purchase by the exporter or other merchandiser.

Furthermore, spreading between two Futures months in the Winnipeg Futures Market, inter-market spreading of these Futures with the Wheat Futures of say, Chicago, and outright speculation all increase the volume of registrations in the Clearing House.

This spreading and speculation, is inspired by traders' opinion that the Winnipeg Wheat Futures or one of the Futures months is out of "parity," and it has a definite corrective value. *

In addition it should be remembered that 85% of the volume of speculative trading enters the market on the buying side and obviously in the mass is in the farmers' favour.

Charges

A small charge of ½c per 1,000 bushels is made on all trades cleared. This is paid by the members of the Clearing House.

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* *See page 39.*

Chapter Eight

IN GENERAL

(N.B.—Written during Second World War.)

It is not claimed that the Winnipeg Grain Exchange and the facilities it provides are incapable of improvement. Far from this being so, the By-laws, Rules and Regulations, are from time to time amended to meet changing conditions.

No more effective evidence of this can be offered than that of the adaptability of the Exchange in meeting the extraordinary demands made on it and its facilities by the necessities of the War.

The control of trading which the Exchange instituted in the early days of September, 1939, the first restrictive shock arising out of the difficulties of Foreign Exchange, down to the imposition of ceiling prices, have only served to emphasize not only the readiness of the members to put the War Effort first, but also the skill with which the services at the disposal of the Exchange were made to contribute to that effort.

Despite the curtailment of international trade which has made the United Kingdom by far the largest buyer of Canadian wheat, the Wheat Futures Market has continued to function although much restricted in character. It is still a market, a place where buyer and seller do meet.

That same Futures Market has provided a medium through which the Canadian Wheat Board have sold hundreds of millions of bushels of wheat to the British Government.

It has through these War years enabled Canadian mills to pay prices for wheat much closer in relation to the price of flour than would have been possible if there had been no Futures Market in which to hedge their purchases.

It has facilitated the sale of millions of bushels of the lower grades of wheat for stock-feeding purposes at a much narrower selling cost than if there had been no hedging facilities.

It has established a price yardstick for export sale of many million bushels of wheat and flour to neutral countries.

The British Government have asked more than once that the Futures Market be kept open and it is not difficult to visualize the reasons for this.

Having bought large blocks of Futures from the Canadian Wheat Board, they know that their basic price is settled and all that remains to be done is to exchange these Futures for the cash wheat for shipment by their own steamers from whichever seaboard ports and at whatever dates they desire.

They pay regular importers in the British Isles a small commission to buy wheat from exporters on this side of the Atlantic stipulating that on every cargo they buy, these exporters shall take over from the Canadian Wheat Board an equivalent amount of Futures, thereby gradually reducing the amount of Futures the British Government had purchased from the Canadian Wheat Board.

In making their purchases from exporters at prices f.o.b (free on board) the seaboard "basis exchange of Futures," the British Government rely on keen competition among these exporters to keep their scale of profit down to a slender margin. They also rely on competition in all the services which the exporters employ in moving the wheat from the Head of the Lakes to the seaboard.

They believe, and it is a widely-held opinion, that better and more economical service can be obtained through open competition than by any form of concentrated merchandizing whether that be of the character of trusts, monopolies, pools or even the Canadian Wheat Board.

This in no way detracts from the able and efficient manner in which the operations of the Canadian Wheat Board have been conducted during the War.

The danger would be that if anything should happen to make the Futures Market futile, the post-war period might see some form of concentration which would threaten to postpone indefinitely that return to broad international trade, which, it is maintained, is not only in the general interest, but is so essential to the prosperity of the farmers of Western Canada.

APPENDIX

H. L. SAUNDERS

Sold Winnipeg, JAN 191

5	May	N B B	77	3/8
30		Eastern		7/8
5		Parent		7/8
10	July	Norris	79	
15		do	79	1/8
5		Woods	79	1/8

Trading Card — Sales

H. L. SAUNDERS

Bought Winnipeg, 194

5	May	Pioneer	77	3/8
5		N Star		3/4
5		Stevens		
10		N B B	77	7/8 - 78
5		A P	77	5/8
10		Dom Coal		7/8
5		Parent		7/8
30	July	Eastern	79	1/8

Trading Card — Purchases

NOTE — WRITE NAMES AND MONTH OF GRAIN PLAINLY
KEEP EACH MONTH DISTINCTLY SEPARATE

WINNIPEG GRAIN & PRODUCE EXCHANGE
CLEARING ASSOCIATION LIMITED

SOLD BY H. L. SAUNDERS DATE JAN 2 - 1942 19

TO WHOM SOLD	WHEAT		PRICE	CLOSE	DR	CR
N G G	5 May		77 5/8	77 5/8	25 –	
Eastern	30		77 5/8			
Parrish	5		77 5/8			
	40 May				25 –	

NOTE — WRITE NAMES AND MONTH OF GRAIN PLAINLY
KEEP EACH MONTH DISTINCTLY SEPARATE

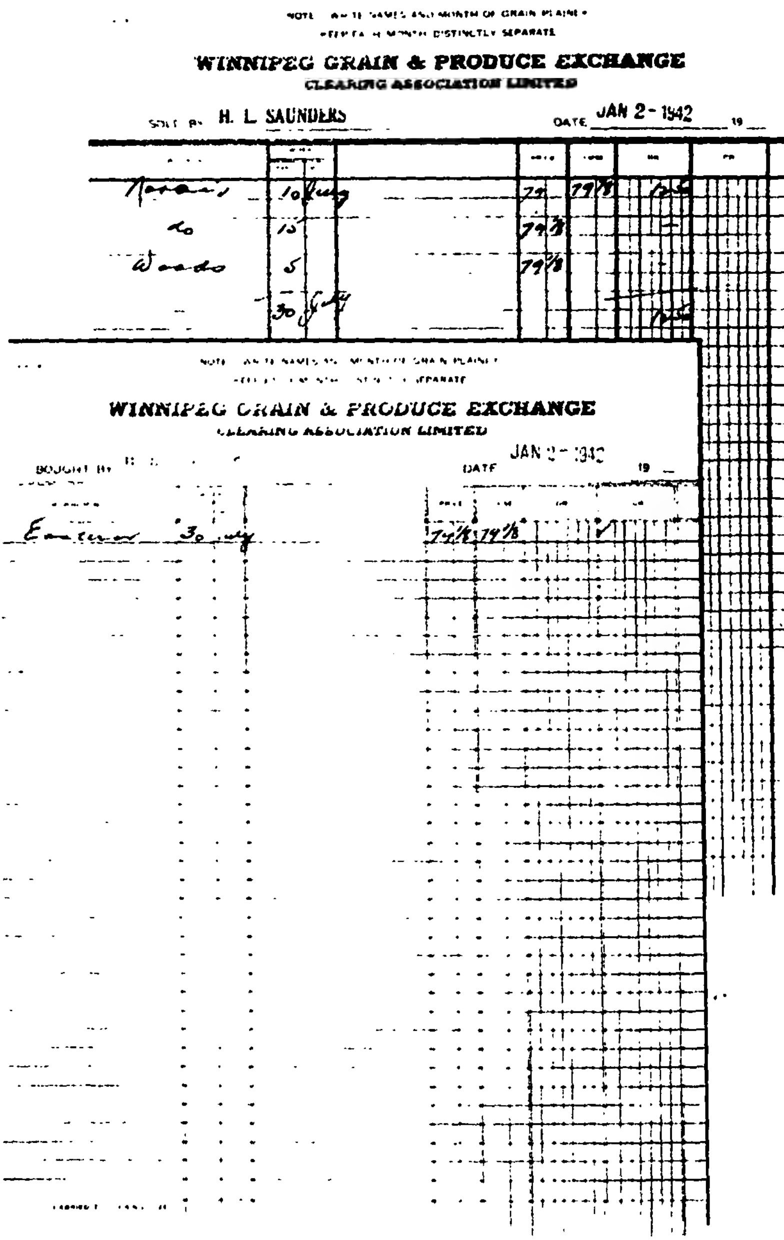
WINNIPEG GRAIN & PRODUCE EXCHANGE
CLEARING ASSOCIATION LIMITED

BOUGHT BY H. L. SAUNDERS DATE 1942 19

OF WHOM BOUGHT	WHEAT		PRICE	CLOSE	DR	CR
Pioneer	5 May		77 5/8	77 5/8		25 –
N Ple.	5		77 1/2			6.25
Stevens	5		77 1/2			6.25
N G G	10		77 5/8 - 78		6.25	
N P	5		77 3/8			12.50
Sask Pool	10		77 5/8			
Parrish	5		77 5/8			
	45 May				6.25	50 –

CARRIED TO CLEARING SHEET

Clearing Sheets — May Wheat — Sales and Purchases



WINNIPEG GRAIN & PRODUCE EXCHANGE
CLEARING ASSOCIATION LIMITED

SOLD BY H. L. SAUNDERS — DATE JAN 2 - 1942 19

Norris	10 July	79	79 1/8	
do	15	79 1/8		
Woods	5	79 1/8		
	30 July			

WINNIPEG GRAIN & PRODUCE EXCHANGE
CLEARING ASSOCIATION LIMITED

BOUGHT BY — DATE JAN 2 - 1942 19

Ennis	30 July	79 1/8	79 1/8	✓

Clearing Sheets — July Wheat — Sales and Purchases

SPECIAL MONTH WHEAT

WINNIPEG GRAIN & PRODUCE EXCHANGE

CLEARING ASSOCIATION LIMITED

FIRM NAME H. L. SAUNDERS

CLOSING SHEET

PHONE 96 936

DATE JAN 2 - 1942 19

WHEAT LONG	WHEAT SHORT	WHEAT MONTH			PREV CLOSE	TODAY'S CLOSE		TOTAL FROM TRADE SHEETS DR	TOTAL FROM TRADE SHEETS CR
75	40	May						25 -	
								6 25	50 -
							Grand Total Dr and Cr	31 25	50 -
30		May		(NOTE)	77 7/8	77 7/8			150 -
								168 75	
							TOTAL	200 -	200 -
35		May							

Clearing Sheet — Closing Sheet — May Wheat

NOTE:—WRITE NAMES AND MONTH OF GRAIN PLAINLY
KEEP EACH MONTH DISTINCTLY SEPARATE

WINNIPEG GRAIN & PRODUCE EXCHANGE

CLEARING ASSOCIATION LIMITED

CLOSING SHEET

FIRM NAME H. L. SAUNDERS

PHONE 96 936

DATE JAN 2 - 1942 19

WHEAT LONG	WHEAT SHORT	WHEAT MONTH		PREV CLOSE	TODAY'S CLOSE	TOTAL FROM TRADE SHEETS DR	TOTAL FROM TRADE SHEETS CR
30	30	July				1250	
			NOTE		GRAND TOTAL DR AND CR	1250	
							1250
					TOTAL	1250	1250
Even							

Clearing Sheet — Closing Sheet — July Wheat

NOTE:—WRITE NAMES AND MONTH OF GRAIN PLAINLY

KEEP EACH MONTH DISTINCTLY SEPARATE

WINNIPEG GRAIN & PRODUCE EXCHANGE

CLEARING ASSOCIATION LIMITED

CASH CLOSING SHEET

FIRM NAME H. L. SAUNDERS

PHONE 97 015

DATE JAN 2 - 1942 19

		DR.	CR.
Carried from Future Closing Sheet JULY [redacted]	(Wheat)	12 50	
Carried from Future Closing Sheet Special MAY [redacted]	(Wheat)		168 75
Carried from Future Closing Sheet	(Coarse Grain)		
ERRORS AND ADJUSTMENTS	(Wheat)		
	Special (Wheat)		
	(Coarse Grain)		
	(Cash Closing and Invoice Clearing)		
Carried from Invoice Clearing Sheet			
YOUR ~~OUR~~—CHEQUE FOR BALANCE		156 75	
	TOTAL	168 75	168 75

Clearing Sheet — Cash Closing Sheet

CONTRACT GRADES

Deliverable on Futures Contracts in the Futures Market of the Winnipeg Grain Exchange in 1942.

Wheat

Contract Grade: No. 1 Manitoba Northern Wheat with the privilege of delivering on contracts:

(a) Higher grade Wheat.

(b) No. 2 Manitoba Northern Wheat at a discount of 3c per bushel.

(c) No. 3 Manitoba Northern Wheat at a discount of 8c per bushel.

(d) No. 4 Manitoba Northern Wheat at a discount of 18c per bushel.

(e) Special No. 4 Wheat at a discount of 22c per bushel.

(f) No. 1 C.W. Garnet Wheat at a discount of 12c per bushel.

(g) No. 2 C.W. Garnet Wheat at a discount of 15c per bushel.

Oats

Contract Grade: No. 2 Canada Western Oats with the privilege of delivering on contracts:

(a) Higher grade Oats.

(b) Extra No. 3 Canada Western Oats at a discount of 3c per bushel.

(c) No. 3 Canada Western Oats at a discount of 3c per bushel.

(d) Extra No. 1 Feed Oats at a discount of 3c per bushel.

(e) No. 1 Feed Oats at a discount of 5c per bushel.

Barley

Contract Grade: No. 2 Canada Western six-row Barley with the privilege of delivering on contracts:

(a) No. 1 Canada Western six-row Barley No. 1 Canada Western two-row Barley No. 2 Canada Western two-row Barley	At the same price.

(b) No. 3 Canada Western six-row Barley at a discount of 2c per bushel.

(c) No. 1 Feed Barley at a discount of 4c per bushel.

Flaxseed

Contract Grade: No. 1 Canada Western Flaxseed with the privilege of delivering on contracts:

No. 2 Canada Western Flaxseed at a discount of 4c per bushel.

Rye

Contract Grade: No. 2 Canada Western Rye with the privilege of delivering on contracts:

(a) No. 1 Canada Western Rye at the same price.

(b) No. 3 Canada Western Rye at a discount of 5c per bushel.

GLOSSARY OF TRADE TERMS